Supreme Court, U.S.
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No.

In The

Supreme Court of the United States

October Term, 1998

LEONARD S. SANDS, FIRST PACIFIC BANCORP and PACVEN, INC.,

Petitioners,

vs.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Has the offeror of a public offering of stock who receives an investor's check for the necessary number of shares before the investment deadline satisfied the requirement of 17 C.F.R. § 240.10b-9(a)(2)(ii) that "the total amount due to the seller [be] received by him by a specified date" if the check does not clear before the deadline but is not later dishonored?

PARTIES TO THE PROCEEDING

Neither First Pacific Bancorp nor Pacven Inc. has any parent companies or nonwholly owned subsidiaries.

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The opinion of the United States Court of Appeals for the Ninth Circuit is reported at *Securities and Exchange Commission v. First Pacific Bancorp*, 142 F.3d 1186 (9th Cir. 1998) (Appendix A). The opinion of the United States District Court for the Central District of California is reported at *Securities and Exchange Commission v. Sands*, 902 F. Supp. 1149 (C.D. Cal. 1995) (Appendix B). The judgment of the District Court, dated August 28, 1996, appears as Appendix C. The findings of facts and conclusions of law of the District Court, dated August 28, 1996, is omitted as a separate lodging.

STATEMENT OF JURISDICTION

The judgment of the United States Court of Appeals for the Ninth Circuit ("Court of Appeals") was entered on April 28, 1998 (Appendix E). The Court of Appeals denied a timely petition for rehearing on July 20, 1998 (Appendix D).

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

15 U.S.C. § 78j provides in part:

§ 78j. Manipulative and deceptive devices

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

17 C.F.R. § 240.10b-9 provides in part:

§ 240.10b-9 Prohibited representations in connection with certain offerings.

(a) It shall constitute a "manipulative or deception device or contrivance", as used in section 10(b) of the Act, for any person, directly or indirectly, in connection with the offer or sale of any security, to make any representation:

(2) To the effect that the security is being offered or sold on any other basis whereby all or part of the consideration paid for any such security will be refunded to the purchaser if all or some of the securities are not sold, unless the security is part of an offering or distribution being made on the condition that all or a specified part of the consideration paid for such security will be promptly refunded to the purchaser unless (i) a specified number of units of the security are sold at a specified price within a specified time, and (ii) the total amount due to the seller is received by him by a specified date.

STATEMENT OF THE CASE

A. History of the Litigation

The Securities and Exchange Commission ("SEC") commenced this civil enforcement action against petitioners First Pacific Bancorp ("Bancorp"), PacVen, Inc., and Leonard S. Sands (chief executive officer for Bancorp and PacVen) for violations of the antifraud, filing, and disclosure provisions of the federal securities laws. The District Court granted summary judgment to the SEC on some of its claims. *Securities and Exchange Commission v. Sands*, 902 F. Supp. 1149 (C.D. Cal. 1995). After a bench trial, the District Court ruled in the SEC's favor on the remaining claims. The District Court permanently enjoined the defendants from future violations of the securities laws, ordered them to disgorge $688,000 plus pre-judgment interest, and permanently barred Sands from acting as an officer or director of a public company. *See* judgment, findings of fact, and conclusions of law dated August 28, 1996.

On appeal, the Court of Appeals for the Ninth Circuit affirmed. *Securities and Exchange Commission v. First Pacific Bancorp*, 142 F.3d 1186 (9th Cir. 1998) ("*Bancorp*"). On July 20, 1998, the Court of Appeals denied petitioners' petition for reargument and suggestion for reargument en banc.

B. Factual Background

As the Court of Appeals found, "The transaction which underlies most of the issues in this appeal was the Bancorp's 1987 public offering of securities." (App. A at 7a). This offering required Bancorp to raise $1,500,000 by selling a minimum of 750 "units" of stock for $2,000 each on an all-or-nothing basis by October 10, 1987. If 750 units were not sold by the deadline, the offering was to be canceled and all collected funds were to be returned to the investors. *Id.*

By October 9, 1987, $1,688,000 had been collected in the form of checks. This sum included a check for $1,000,000 issued by Savoy Reinsurance Company and drawn on the Bank of Montreal, Bahamas Ltd. The check was signed by Savoy's chairman, Paul Kutik (App. A at 8a) and countersigned by a second Savoy official.[1] This check was later returned unpaid, *id.*, because of an unspecified technical defect unrelated to its validity or to the sufficiency of the funds it was drawn against.[2] Petitioners promptly resubmitted the check for reprocessing. The SEC never contended that the check was invalid or written against insufficient funds, or that Sands and the other petitioners were not diligent in processing it.

Although Bancorp presented the Savoy check to its escrow bank upon receipt,[3] it took a long time to process for a number of reasons outside Bancorp's control. First, Union Bank, which was the subscription agent and escrow holder for the offering (and with which petitioners had no involvement), inexplicably held the check for at least ten days without taking any steps to process it.[4]

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1. Plaintiff's supplemental statement of facts genuinely in dispute, exhibit 57.

2. There are numerous situations in which a check might be returned without being dishonored. For example, return of a check because it lacks proper indorsement is not dishonor. U.C.C. § 3-507(3) (1962); U.C.C. § 3-501(b)(3)(i) (1990); Bailey & Hagedorn, *Brady on Bank Checks* ¶ 22.02 at 22-3 (rev. ed. 1997). Likewise, other grounds for refusal to pay that do not constitute dishonor include remediable defects such as "indorsement missing, signature missing, signature illegible, forgery, payee altered, postdated, and not on us." *Id.*, citing U.C.C. § 3-510 comment 2 (1962).

3. Plaintiff's statement of uncontroverted facts and conclusions of law, exhibit 7.

4. Plaintiff's supplemental statement of facts genuinely in dispute, exhibit 57.

Additional delays[5] were occasioned by the multinational operations involved in processing a check drawn on the Bahamas branch of a bank headquartered in Canada, and by the normal procedures incident to the processing of a returned check.[6]

On December 30, 1987, while the check was still in the process of clearing, and with Savoy's consent, Sands bought out Savoy's position with $1,000,000 of his own funds. *Id.*

REASONS FOR GRANTING THE WRIT

I.

THE OPINION BELOW CONFLICTS WITH PRIOR DECISIONS OF OTHER COURTS OF APPEALS AND SUBSTANTIALLY AFFECTS RULES OF NATIONAL APPLICATION IN WHICH THERE IS AN OVERRIDING NEED FOR NATIONAL UNIFORMITY.

The petition should be granted because the opinion of the court below changes the accepted standard in the securities industry for determining when the requirements of a public offering are presumptively met, and changes the generally-

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5. *Id.*

6. The treatment of check returns is dramatically different from that of check collections. When a check is forwarded for collection, it receives the benefit of jet couriers and expedited high speed processing. In sharp contrast, items that have been returned, for whatever reason, are handled manually. . . . Because this is a labor-intensive process, it is slower and more prone to human error.

Jordan, "Ending the Floating Check Game: The Policy Arguments for Delayed Availability Reform," 36 *Hastings L.J.* 515, 531-32 (1985).

accepted practice in the business world of treating a check as presumptive payment.[7]

For purposes of this petition, the critical passage of the opinion of the Court of Appeals is the following:

> Sands . . . contends that the minimum requirement of the offering was satisfied because a sufficient amount was received in the form of checks by the deadline. We reject that argument. . . . Bancorp had to receive "the total amount due" to it, i.e. $1,500,000, by the October 10 deadline. A check is merely a "promise to pay." See Black's Law Dictionary 237 (6th ed. 1990). As this case vividly demonstrates, the receipt of a "promise to pay" $1,000,000 is not equivalent to the receipt of the actual "amount due" because the check may fail to clear. Had the check cleared in the regular course of business but after the deadline, it could be argued that the result should be different, but we need not decide *that* issue. On the facts of this case, Bancorp did not raise the $1,500,000 amount by the October 10 deadline as was required by the terms of the offering.

(App. A at 10a). (Emphasis in original).

In other words, the Court of Appeals distinguished two situations: receipt before the offering deadline of a check that clears after the deadline, and receipt before the offering deadline

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7. Petitioners raised this issue in the Court of Appeals. *E.g.*, defendants-appellants' amended opening brief at 34: "There is no authority to support the proposition that the checks must have cleared by the deadline."

of a check that ultimately does not clear.[8] The court expressly declined to address the former circumstance, but held that in the latter it is improper for the offeror to include the check in determining whether the offering minimum has been met by the deadline. *Id.*

However, by deciding one of these issues the Court of Appeals in fact decided both. An offeror receiving checks can never predict which checks will clear and which will fail, because "[m]yriad events can intervene between delivery and presentment of the check that would result in the check being dishonored." *Barnhill v. Johnson*, 503 U.S. 393, 399 (1992); *accord*, U.C.C. § 4-214 comment 2 (1995). For example,

> [t]he drawer could choose to close the account. A third party could obtain a lien against the account by garnishment or other proceedings. The bank might mistakenly refuse to honor the check.

Barnhill, *supra* at 399.

Therefore, by deciding it was improper for Sands to rely on the Savoy check before it cleared, the opinion of the Court of Appeals in effect prohibits offerors from relying, even tentatively, on *any* check still in the clearing process at the end of the offering period. As this Court explained in *Barnhill*, any check may fail. This means an offeror must presume every check is invalid until it actually does clear. If the propriety of the offeror's conduct depends upon whether the check ultimately is honored, no prudent offeror can ever accept any check in satisfaction of an offering requirement unless there is enough time for it to be processed before the deadline.

8. The present case actually involved an intermediate situation in which the clearance process was interrupted by Sands' purchase of Savoy's position.

The effect of this ruling is to restrict the sale of securities to a cash basis whenever a deadline for a minimum sale is involved. This is contrary to the normal business practice in the securities industry, in which checks are commonly accepted, even up to the last minute, in the expectation that they will clear later. *See, e.g., Green v. Weis, Voisin, Cannon, Inc.*, 479 F.2d 462, 463 (7th Cir. 1973) ("Each of the plaintiffs accepted the offer to purchase by signing the investment letter and sending it, with a check"); *Slagell v. Bontrager*, 616 F. Supp. 634, 636-37 (W.D. Pa.), *aff'd*, 791 F.2d 921 (3rd Cir. 1986) ("[I]n the case of an unregistered security, the [limitations] period begins to run when the investor is first offered the security, which in this case must have occurred . . . when plaintiff wrote her check"); *Parvin v. Davis Oil Co.*, 524 F.2d 112, 117 (9th Cir. 1975) ("[P]ayment . . . in the form of a check . . . constituted a sale of securities"); *In re Baker & Getty Financial Services, Inc.*, 106 F.3d 1255, 1260 (6th Cir.), *cert. den. sub nom. Wesbanco Bank Barnesville v. Customer Creditors*, __ U.S. __, 118 S. Ct. 65, 139 L. Ed. 2d 27 (1997) (purchase of securities by check); *Sennott v. Rodman & Renshaw*, 474 F.2d 32, 34-36 (7th Cir.), *cert. den.*, 414 U.S. 926 (1973) (same); *Sahley v. McKee*, 371 F.2d 720, 721 (2d Cir. 1967) (same); *Brown v. Financial Service Corp., International*, 489 F.2d 144, 147 (5th Cir. 1974) (contract providing that "the [buyer] shall make payment for the stock . . . in cash or by check and [the seller] shall, immediately upon making of such payment, deliver to the Company valid title to said stock . . . free of all claims, liens, and encumbrances of any nature whatever").

The ruling is also contrary to national business practices in general, which treat a check as presumptive payment made at the time it is received. A check is not "merely a promise to pay," as the Court of Appeals ruled in *Bancorp* (App. A at 10a) relying solely upon Black's Law Dictionary 237 (6th ed. 1990).

Rather, as the other Courts of Appeals recognize, in American commerce a check is usually regarded as payment itself.[9]

> Checks, the most common items handled by the banks, are dealt with in bulk as "cash" items on the assumption that they will be honored in the overwhelming majority of cases; provisional credits are entered immediately for a check at all states of the collection process and automatically become final without further action upon payment by the drawee bank.

First Texas Savings Association v. Reliance Insurance Co., 950 F.2d 1171, 1176 n.4 (5th Cir. 1992). *Accord, e.g., In re Barefoot*, 952 F.2d 795, 798 (4th Cir. 1991) ("[I]n the commercial arena, for most purposes, payment by check is the end of a commercial transaction") (citation omitted); *In re Kroh Brothers Development Co.*, 930 F.2d 648, 651 (8th Cir. 1990) ("[C]reditors who ordinarily provide goods to purchasers on credit treat a payment by check as a cash transaction, and therefore ship a new order of goods upon receipt of a check"); *In re New York City Shoes, Inc.*, 880 F.2d 679, 683 (3d Cir. 1989) ("In most cases, absent a post-dated check or a request to hold the check, parties in a normal business transaction would . . . treat a check as a cash transaction and extend new credit immediately upon receiving a check in payment of a prior debt rather than waiting until the check has cleared to send new goods"); *In re White River Corp.*, 799 F.2d 631, 634 (10th Cir. 1986) ("[I]n the commercial world receipt of a check, as distinguished from the date it clears the drawee bank, is

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9. A check technically "suspends" an obligation until the check is paid or dishonored. *E.g., Barnhill, supra*, 503 U.S. at 398; U.C.C. § 3-310(b) (1990). However, as the sources cited in the ensuing text demonstrate, statutes, case law, and common business practices all treat a check as payment in most ordinary business transactions.

customarily looked upon as the date of payment of an obligation") (citation omitted); *O'Neill v. Nestle Libbys P.R., Inc.*, 729 F.2d 35, 37 (1st Cir. 1984) ("To treat checks as cash payments is . . . in accord with commercial reality"); *see also* 31 U.S.C. § 3901(a)(5) ("[A] payment is deemed to be made on the date a check for payment is dated. . . ."); U.C.C. § 2-511 comment 4 (1990) ("[T]he taking of a seemingly solvent party's check is commercially normal and proper and, if due diligence is exercised in collection, is not to be penalized in any way"); Bailey & Hagedorn, *Brady on Bank Checks* ¶ 4.06[1] at 4-24-25 (rev. ed. 1997) ("[M]ost courts in nonbankruptcy cases have held that the time of payment of the debt is the time when the check is received by the payee-creditor rather than the later time when the check is paid by the debtor's bank").[10] State courts agree. *E.g.*, *Robbennolt v. Snap-On Tools Corp.*, 555 N.W. 2d 229, 236 (Iowa 1996) ("As to a check that was delivered to him, the payment is 'made' on the date of delivery"); *Tooley v. Robinson Springs Corp.*, 163 Vt. 627, 628,

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10. A limited exception to this principle arises under 11 U.S.C. § 547(b), which authorizes trustees in bankruptcy to avoid certain transfers of the debtor's interests. In this context, "[f]or the purposes of payment by ordinary check, . . . a 'transfer' . . . occurs on the date of honor, and not before." *Barnhill, supra*, 503 U.S. at 400. This exception to the general rule is limited by 11 U.S.C. § 547(c), which lists numerous bankruptcy situations in which the date of delivery of the check, rather than the date of payment, controls. *Barnhill, supra*, 503 U.S. at 402.

Neither of the rationales underlying these two provisions of the Bankruptcy Code is relevant to public offerings of securities. Section 547(b) is construed in favor of the date the check clears to further its purpose of avoiding transfers benefitting selected creditors. *In re Belknap, Inc.*, 909 F.2d 879, 883 (6th Cir. 1990). Section 547(c), which follows the general commercial rule in favor of the date the check is received, is "designed to encourage creditors to continue to deal with troubled debtors on normal business terms." *Barnhill, supra*, 503 U.S. at 402. These bankruptcy policies are not involved in public offerings of securities.

660 A.2d 293, 295 (1995) ("[P]ayment on a check relates back to the time the check was delivered").

This is a sensible and practical convention in light of the "stability over time" of the fact that virtually all checks are good and will be honored when first presented. Jordan, "Ending the Floating Check Game: The Policy Arguments for Delayed Availability Reform," 36 *Hastings L.J.* 515, 516 (1985) (more than 99.3% of checks are honored at first presentment);[11] *First Texas Savings Association, supra*, 950 F.2d at 1176 n.4 (5th Cir. 1992) (banks assume checks "will be honored in the overwhelming majority of cases"); U.C.C. § 4-214 comment 1 (1995) (the "vast majority" of checks are ultimately paid).

The decision of the Court of Appeals is contrary not only to these specific commercial conventions, but to all three general "purposes and policies" of the U.C.C. as set forth in § 1-102(2) (1990). First, it does not "simplify, clarify and modernize the law governing commercial transactions," *id.* at § 1-102(2)(a), because it promotes a cash economy rather than one based upon checks and credit. Second, it does not "permit the continued expansion of commercial practices through custom, usage and agreement of the parties," *id.* at § 1-102(2)(b), because it invalidates the universal practice in commerce generally and in the securities field in particular of treating the delivery of a check as payment. Third, it does not "make uniform the law among the various jurisdictions," *id.* at § 1-102(2)(c), because the law of the Ninth Circuit is now in conflict with that of all other circuits.

Until its decision in *Bancorp*, the Ninth Circuit followed the national rule. *E.g.*, *In re Nucorp Energy, Inc.*, 92 B.R. 416,

11. The Jordan article was published only two years before the 1987 Bancorp offering and reflects the state of the banking industry at that time.

417 (9th Cir. Bankr. App. 1988) ("The general rule in the Ninth Circuit is that the transfer of payment by check occurs on the date that the check is delivered"); *In re Wolf & Vine*, 825 F.2d 197, 200 (9th Cir. 1987) ("[A] check transfer takes place at delivery").

The securities field is governed by common commercial understandings. *See, e.g., Pommer v. Midwest Corp.*, 961 F.2d 620, 625 (7th Cir. 1992) (sales of securities are controlled by the ordinary law of contracts). These understandings include the notion that receipt of a check is considered payment. Both types of parties to a stock transaction routinely rely upon this convention. Offerors commonly accept subscriptions until time runs out. Likewise, investors commonly assume they may subscribe up to the deadline, and for any number of reasons may wait until the last minute before making their commitment. If the deadline arrives after sufficient checks are received but before they can clear, the offeror treats the offering as presumptively successful. If the checks ultimately fail, the offeror then treats the offering as unsuccessful and returns the investors' money. The effect of *Bancorp* is to diminish every offering period by requiring all the checks to clear in advance.

This diminution is likely to be substantial for many offerings, as the delays involved in the present case are not unusual.[12] At the time of the Savoy check, there had recently been a "dramatic increase in the number of large value checks that [were] processed initially through an intentionally indirect, circuitous route." Jordan, *supra*, 36 *Hastings L.J.* at 559. The amount of time necessary for all checks to clear could preclude the success of the offering, particularly when the offeror solicits subscriptions in other states or countries.

12. Delay in processing a check does not indicate the check's invalidity. *E.g., United States v. Cordell*, 912 F.2d 769, 772 n.4 (5th Cir. 1990).

Besides impeding sales and purchases of securities, the new principle adopted by the Court of Appeals may profoundly affect commerce in other ways. As explained above, the securities industry is governed by ordinary commercial principles, and the Court of Appeals did not indicate that its ruling was limited to sales of stock. Indeed, since the only authority the court cited was the definition of *check* in *Black's Law Dictionary*, the ruling appears to be one of general application. Therefore, banks and other financial and investment institutions, as well as other businesses and government agencies, may perceive no logical reason why the holding in *Bancorp* should not extend to them.

For example, based upon the holding of the Court of Appeals that a check is "merely a promise to pay," "the general rule . . . that a check constitutes taxable income to a cash-basis taxpayer when received"[13] should no longer apply. Similarly, income tax payments mailed on April 15 may now be deemed late unless the taxpayer pays in cash. The general practice under the Uniform Commercial Code of treating delivery of a check as payment[14] will be in question. Even rent payments arguably will be late if made by check on the first of the month, unless the lease specifically authorizes a "promise to pay" in lieu of payment.

Whether banks, creditors, sellers, and other parties in the commercial world will voluntarily accept checks as payment despite this decision is not the primary point. The ruling of the Court of Appeals appears to make that practice elective, giving

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13. *Walter v. United States*, 148 F.3d 1027, 1029 (8th Cir. 1998), citing *Avery v. Commissioner*, 292 U.S. 210, 215 (1934).

14. *Staff Builders of Philadelphia, Inc. v. Koschitzki*, 989 F.2d 692, 694 (3d Cir. 1993), citing U.C.C. § 3-802(1)(a) (1962) and 6 R. Anderson, *Uniform Commercial Code* 3-802:19 (1984).

the recipient of a check a new legal justification for choosing not to treat it as cash payment. While creditors will remain free to continue treating checks as payment if they wish, obligors may incur liability by believing that delivery of a check rather than cash will suffice whenever a debt is due. This in turn makes creditors, depositors, and purchasers hesitant to pay by check, and perhaps by extension, by credit card as well. The decision of the Court of Appeals not only changes ordinary practices in the securities field, which itself is a serious concern, but encourages a return in all commercial spheres to a cash economy.

II.

THE FACTS OF THIS CASE ILLUSTRATE THE UNFAIRNESS AND IMPRACTICALITY OF THE RULE ADOPTED BY THE COURT OF APPEALS.

In the present case, the Savoy check was never dishonored; it was returned because of a technical defect, was redeposited, and was in the process of clearing when Sands purchased Savoy's position. There was never an indication that Savoy did not intend to honor the check or that it was backed by insufficient funds. Since "parties in a normal business transaction . . . treat a check as a cash transaction," *New York City Shoes*, *supra*, 880 F.2d at 683, and there was no indication that the Savoy check would not ultimately clear, it was proper for Bancorp to treat the offering as presumptively satisfied and then, with Savoy's consent, for Sands to buy out Savoy's position after the subscription deadline. While Sands' conduct would have been unjustified if he had purposely caused the slow processing of the Savoy check, or if he did not believe Savoy to be a bona fide investor, neither of those circumstances was present. Sands therefore acted appropriately in treating the Savoy check as presumptively valid, as anyone else in the banking business would have done.

The legitimacy of Sands' actions may be more clearly apparent if one considers what would have happened if there had not been a minimum sale requirement, or if that requirement had already been satisfied before Savoy delivered its check. If Sands had not purchased Savoy's position, and Savoy's check ultimately had failed, Bancorp could have sued Savoy for damages or for specific performance of its promise to buy Bancorp stock. *E.g.*, *Leaseco Corp. v. Taussig*, 473 F.2d 777, 786 (2d Cir. 1972). Savoy could have sought similar relief against Bancorp if Bancorp had refused to deliver the stock. *E.g.*, *Medcom Holding Co. v. Baxter Travenol Laboratories, Inc.*, 984 F.2d 223, 227-28 (7th Cir. 1993); *Castle v. Cohen*, 840 F.2d 173, 178 (3d Cir. 1988). Thus, substantive rights and obligations were created between Bancorp and Savoy upon receipt of the Savoy check, including Savoy's right to receive stock and Bancorp's right to payment on a negotiable instrument. Both of these kinds of rights are commonly assigned in the business world.[15]

Two hypothetical variations on the facts of the case will illustrate why the transferability of these rights, and in particular the negotiability and presumptive validity of a check, justify Sands' actions. First, if, after the subscription deadline, Sands had given a check directly to Savoy in exchange for the shares due to Savoy, there would be no assertion of wrongdoing even if Savoy's check to Bancorp had not yet cleared, because that would have been a private transaction unrelated to the public offering[16] and the perceptions or concerns of potential

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15. *See* U.C.C. § 3-302 (1990) (assignment of checks); *e.g.*, *General Life of Missouri Investment Co. v. Shamburger*, 546 F.2d 774, 779-80 (8th Cir. 1976); *Sperry v. Barggren*, 523 F.2d 708, 709 (7th Cir. 1975) (assignment of stock interest).

16. The Court of Appeals recognized there was no inherent restriction against Sands investing in the offering. (App. A at 11a).

investors.[17] Second, again after the deadline, if Bancorp had assigned the Savoy check to Sands in return for his own check in an equal amount, there would have been no violation of the securities laws, either.

There is in fact no substantive difference between these hypothetical situations and Sands' actual course of conduct. If Sands could have bought the Savoy check from the bank for full value, or bought the shares from Savoy for full value, there is no logical reason why he could not effect the same result in a single transaction involving both parties. The Savoy check was a negotiable instrument of presumptive validity, and it was inherently transferable.

As the Court of Appeals stated, the 1987 offering was the "transaction which underlies most of the issues in this appeal." (App. A at 7a). Once that transaction is understood in light of the common business practices involved in the offering of securities, the misconduct of Sands and the corporate defendants is greatly diminished. The determination of scienter on Sands' part, and the ensuing harsh penalty, resulted from the conclusion that Sands acted fraudulently in deeming the offering satisfied and then purchasing Savoy's shares. However, those acts were consistent with the accepted practice in the national securities industry and in the general world of commerce of treating delivery of a check as presumptive payment.

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17. *See* Appendix A at 12a (one purpose of the "all-or-nothing" requirement is to provide a "reasonable indication" to investors of the value of the stock).

CONCLUSION

This case presents the critical question of whether delivery of a check still constitutes immediate presumptive payment of an obligation. The answer to this question affects daily business practices not only in the securities industry, but in all other commercial domains as well. The decision of the Court of Appeals for the Ninth Circuit conflicts with decisions of every other Court of Appeals to address the question, and requires definitive resolution so practices in the securities industry and other commercial areas will be consistent across the country.

Petitioners therefore request that the petition be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT FILED APRIL 28, 1998 FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellee,
v.
FIRST PACIFIC BANCORP; PACVEN, INC.,
Defendants-Appellants,
and
LEONARD S. SANDS; CHARLES W. KNAPP; BERRIEN MOORE; DANIEL S. GEIGER; MULK RAJ DASS; APEX INVESTMENT SECURITIES, LTD.,
Defendants.

No. 96-56687
D.C. No. CV-93-07510-JGD
OPINION

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellee,
v.
LEONARD S. SANDS,
Defendant-Appellant,
and
FIRST PACIFIC BANCORP; PACVEN, INC.; CHARLES W. KNAPP; BERRIEN MOORE; DANIEL S. GEIGER; MULK RAJ DASS; APEX INVESTMENT SECURITIES, LTD.,
Defendants.

No. 96-56690
D.C. No. CV-93-07510-JGD

Appendix A

Appeal from the United States District Court
for the Central District of California
John G. Davies, District Judge, Presiding

Argued and Submitted
April 7, 1998—Pasadena, California

Filed April 28, 1998

Before: Jerome Farris, Diarmuid F. O'Scannlain, and
Ferdinand F. Fernandez, Circuit Judges.

Opinion by Judge Fernandez

SUMMARY

Securities/Fraud

The court of appeals affirmed a judgment of the district court. The court held that under Securities and Exchange Commission (SEC) Rule 10b-9, a corporate insider commits securities fraud by retaining investors' money after the deadline for completion of a public "mini-max" sale, and closing the offering with the insider's own money.

During the 1980s, state and federal regulators repeatedly rated Bancorp "unsatisfactory" due in part to inadequate capital, earnings, and liquidity. To raise additional capital, Bancorp and appellant Leonard Sands, its chairman, chief executive officer, and principal shareholder, commenced a "mini-max" public offering: Bancorp would sell public investors a minimum of 750 "units" at $2000 each on an all-or-nothing basis by October 10, 1987; if all 750 units were not sold by the deadline, the offering was to be cancelled and the funds returned to the investors.

Appendix A

On October 8, 1997, The escrow agent received $1.688 million for investment in the mini-max offering, of which $1 million was in the form of a worthless check written by Paul Kutik on an offshore bank account. Another $500,000 had been raised in a public offering by PacVen, a shell corporation, and fraudulently diverted by Sands to the Bancorp offering. Of the $688,000 Bancorp raised by the deadline, only $188,000 came from bona-fide investors.

Instead of returning the funds to the investors as promised in the offering prospectus, Sands and Bancorp continued the offering past the deadline. With his own funds, Sands bought 500 units for $1 million, which brought the total amount of sales over the minimum required by the offering. The offering was closed and the proceeds delivered to Bancorp.

California bank examiners found that even though Sands was no longer an officer of Bancorp, he retained control of it and continued to extract substantial income from it. Federal bank inspectors determined that Sands had been paying himself excessive compensation to maintain his standard of living.

The SEC commenced a civil action to force Sands, Bancorp, and PacVen to disgorge the $688,000 raised from outside investors, and to have Sands barred from serving as an officer or director of a publicly held corporation. The district court ruled for the SEC on all claims.

On appeal, Sands contended that even though Kutik's check bounced, the minimum requirement of the offering was satisfied because a sufficient amount was received, and Sands acquired Kutik's "position," before the deadline. Sands also complained that he should not have been required to disgorge the proceeds because he received no personal financial benefit as a result of the offering. He also asserted that the district court ordered restitution, not disgorgement, and that he was

unfairly surprised and had no opportunity to raise defenses to the disgorgement remedy.

[1] Rule 10b-9 provides that funds invested in a mini-max offering must be refunded to investors unless a specified number of units of the security are sold at a specified price within a specified time, and the total amount due is received by the seller by a specified date. Bancorp had to receive $1.5 million by the October 10 deadline. A check is merely a promise to pay. Receipt of a promise to pay $1 million is not the equivalent to the receipt of the actual amount due because the check may fail to clear. Bancorp did not raise the $1.5 million by the deadline.

[2] Because Kutik's check never cleared, his "position" in the offering amounted to zero. Sands' purchase of the 500 units that Kutik merely *wished* to purchase, occurred after the deadline, and therefore after the offering had failed. [3] That Sands made a real investment was not determinative because it occurred after the offering had failed. The other investors' funds should have been returned.

[4] In a mini-max offering, scienter is shown by a defendant's knowledge of the minimum requirement, and that the funds were retained even though the minimum amount was not raised. When the $1 million check from Kutik was returned unpaid, Sands knew that Bancorp had failed to raise $1.5 million as required by the offering. Instead of refunding the $688,000 to the investors, Sands retained those funds and closed the offering by investing $ 1 million of his own money. That itself was fraudulent.

[5] The district court has broad equity powers to order the disgorgement of ill-gotten gains obtained through violation of the securities laws. Further, when two or more individuals or entities collaborate or have a close relationship in violating securities laws, they may be held jointly and severally liable for disgorgement. Sands played the principal role in the fraud-

ulent activities and enjoyed a close relationship with Bancorp and PacVen. It was appropriate to hold Sands and his corporate codefendants jointly and severally liable for their violations of the securities laws.

[6] The infusion of capital from the offering put off a bank failure and enabled Bancorp to remain in operation for two and a half more years. During that time, Sands engaged in "milking the asset" by paying himself hundreds of thousands of dollars. Sands received substantial personal benefit from the infusion of the illegally obtained proceeds from the Bancorp offering, which justified the order directing him to disgorge those proceeds.

[7] Sands' claim of unfair surprise was not supported by the record. Pretrial pleadings filed by the SEC requested that the court order Sands to disgorge the fraudulently retained proceeds, and that they be returned to the investors as restitution. It was clear from the district court's conclusions of law that the remedy was disgorgement. That the court ordered the funds returned to the investors did not change the nature of the remedy.

[8] The district court has broad equitable powers to fashion appropriate relief for violations of the securities laws, which include the power to order an officer and director bar. In addition, the Securities Enforcement Remedies and Penny Stock Reform Act authorizes the court to order an officer and director bar if the person's conduct demonstrates substantial unfitness to serve as an officer or director.

[9] The district court found that Sands' violations were egregious; he caused the collapse of a bank; he attempted to stymie banking regulators from doing their jobs; he was a recidivist; and the fraudulent conduct occurred while he served in a corporate or fiduciary capacity. The court also found that Sands had a high level of scienter; that he engaged in ongoing and recurrent violations; that he failed to assume

responsibility for his violations of law; that he failed to recognize the wrongful nature of his conduct; and that there was a strong likelihood of future violations. There was no error in those findings, and they were sufficient to support the court's decision to protect the public interest by barring Sands from serving as an officer or director of a public company.

COUNSEL

Scott W. Wellman, Wellman & Warren LLP, Irvine, California, for the defendants-appellants.

Mark Pennington, Senior Litigation Counsel, Securities and Exchange Commission, Washington, D.C., for the plaintiffs-appellees.

OPINION

FERNANDEZ, Circuit Judge:

The Securities and Exchange Commission brought a civil enforcement action against Leonard S. Sands, First Pacific Bancorp (Bancorp), and PacVen Inc. for violations of the antifraud, filing and disclosure provisions of the federal securities laws. The district court granted partial summary judgment in favor of the SEC on three of its claims.[1] After a bench trial, the court ruled in favor of the SEC on all of its remaining claims. Sands, Bancorp and PacVen appeal the district court's grant of partial summary judgment. They also appeal the court's final judgment, which permanently enjoins them from future violations of the securities laws, orders them to disgorge $688,000 plus pre-judgment interest, and permanently bars Sands from acting as an officer or director of a public company. We affirm.

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[1] *See SEC v. Sands*, 902 F. Supp. 1149 (C.D. Cal. 1995) (*Sands I*).

Appendix A

BACKGROUND

Sands was the chairman of the board, chief executive officer and corporate counsel of Bancorp, a Delaware corporation organized as a bank holding company, and owned 54% of its common stock. Sands was also the chairman of the board and corporate counsel of First Pacific Bank, Inc. (Bank), the wholly owned subsidiary of Bancorp and its major asset. In addition, Sands was the president and the CEO of PacVen, a Nevada "blank check", also known as "shell", corporation formed for the purpose of merging with or acquiring other companies.

Beginning in the early 1980s, state and federal regulators repeatedly rated the Bank "unsatisfactory" because of its inadequate capital, earnings and liquidity, and because of its increasing amounts of classified assets and past due loans. In the late 1980s, Bancorp and Sands engaged in several financial transactions designed to raise additional capital for the failing Bank. They committed various securities law violations in the process.[2]

The transaction which underlies most of the issues in this appeal was the Bancorp's 1987 public offering of securities. In April of 1987, it commenced a "mini-max" public offering with the intention of downstreaming its proceeds to the financially troubled Bank. Under the terms of the offering, Bancorp was required to sell a minimum of 750 "units," at $2,000 each, on an all-or-nothing basis by August 12, 1987. The underwriter later extended the deadline to October 10, 1987. If all 750 units were not sold by the deadline, the offering was to be cancelled and the funds were to be returned to the investors. If the minimum were reached, Bancorp had a right to sell up to 1,275 units on a best-efforts basis.

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[2]Those efforts were ultimately unsuccessful and the Bank was closed by state regulators on August 10, 1990. *See First Pacific Bank v. Gilleran*, 40 F.3d 1023, 1024 (9th Cir. 1994).

Appendix A

On October 9, 1987, $1,688,000 was forwarded to the escrow agent for investment in the Bancorp offering, but of those funds, $1,000,000 was in the form of a check written by Paul Kutik, chairman of Savoy Reinsurance Company, and drawn on the Bank of Montreal, Bahamas Ltd. That check was later returned unpaid. Also, $500,000 had been raised in a public offering by PacVen in July of 1987, and was fraudulently diverted by Sands into the Bancorp offering.[3] Thus, Bancorp only succeeded in raising $688,000 by the deadline, and only $188,000 of the funds came from bona fide investors. However, Sands and Bancorp did not return the funds to the investors as they had promised in the Prospectus, but instead continued with the offering. On December 30, 1987, the date the offering was scheduled to close, Sands purchased 500 of the Bancorp units, paying $1,000,000 of his own funds. That purchase brought the total amount to $1,688,000. The offering was then closed and the proceeds were delivered to the Bank.

Among other things, the SEC sought to have Sands, Bancorp and PacVen disgorge the $688,000 raised in the Bancorp offering from outside investors, and to have Sands barred from serving as an officer or director of publicly held companies in the future. The district court granted both forms of relief and this appeal ensued.[4]

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[3]PacVen funds were to be used for the purpose of acquiring or merging with another company. While awaiting an opportunity, they were to be held in interest bearing accounts in commercial financial institutions, and its investors were told that there was no intention to enter into a transaction with a business with which an officer or director was affiliated. Nevertheless, within a few short months, Sands had diverted the PacVen money through companies owned by his former associate, Charles Knapp, and into the risky Bancorp offering. The funds were never returned to the PacVen investors.

[4]Aside from their other claims, Sands, Bancorp and PacVen all assert that the district court's findings of fact are not supported by the evidence because the findings refer to some pieces of evidence that were either inadmissible or that were never admitted at trial. We have carefully

Appendix A

JURISDICTION AND STANDARDS OF REVIEW

The district court had jurisdiction pursuant to 28 U.S.C. § 1331. We have jurisdiction pursuant to 28 U.S.C. § 1292(a)(1).

We review the grant of summary judgment de novo. *See Goldblatt v. FDIC*, 105 F.3d 1325, 1327 (9th Cir. 1997). We review the district court's order of disgorgement for abuse of discretion. *See SEC v. Clark*, 915 F.2d 439, 453 (9th Cir. 1990). Similarly, we review the district court's decision to bar Sands from serving as an officer or director of a publicly held company for abuse of discretion. *See SEC v. Posner*, 16 F.3d 520, 522 (2d Cir. 1994).

DISCUSSION

A. *DISGORGEMENT*

Sands and Bancorp object to the district court's grant of summary judgment against them on the SEC's claim that their handling of the Bancorp offering constituted securities fraud. *See Sands I*, 902 F. Supp. at 1162-63. Sands also claims that even if the summary judgment were proper, he should not have been ordered to disgorge $688,000. For convenience, we will only refer to Sands in the ensuing discussion, though, of course, if he were correct about the summary judgment grant, that would inure to Bancorp's benefit also.

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reviewed the findings of fact that refer to the inadmissible or unadmitted evidence, and have determined that none of the material was critical to the district court's findings of liability or the equitable remedies granted by the court. As the findings of fact were very detailed and lengthy (641 findings, 171 pages), the elimination of a few findings had no substantial effect. The findings of fact were adequately supported by admissible and admitted evidence.

Appendix A

(1) *The summary judgment*

We recognize that in reviewing the district court's grant of summary judgment in favor of the SEC, we must view the evidence in the light most favorable to Sands, and determine "whether there are any genuine issues of material fact and whether the district court correctly applied the relevant substantive law." *Goldblatt,* 105 F.3d at 1327. That does not help Sands at all.

[1] Sands cannot dispute that the $1,000,000 check written by Paul Kutik and drawn on the Bank of Montreal, Bahamas Ltd. was returned unpaid. Rather, he contends that the minimum requirement of the offering was satisfied because a sufficient amount was received in the form of checks by the deadline. We reject that argument. Rule 10b-9 expressly provides that funds invested in the mini-max offering must be promptly refunded to the investors unless "(i) a specified number of units of the security are sold at a specified price within a specified time, and (ii) *the total amount due to the seller is received by him* by a specified date." 17 C.F.R. § 240.10b-9 (a)(2) (emphasis added).[5] Thus, Bancorp had to receive "the total amount due" to it, i.e. $1,500,000, by the October 10 deadline. A check is merely a "promise to pay." *See* Black's Law Dictionary 237 (6th ed. 1990). As this case vividly demonstrates, the receipt of a "promise to pay" $1,000,000 is not equivalent to the receipt of the actual "amount due" because the check may fail to clear. Had the check cleared in the regular course of business but after the deadline, it could be argued that the result should be different, but we need not decide *that* issue. On the facts of this case, Bancorp did not raise the $1,500,000 amount by the October 10 deadline as was required by the terms of the offering.

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[5]The SEC has also expressly indicated that where, as here, an offering is contingent upon a specified amount of units being sold, that contingency is not satisfied unless all the securities "are fully paid for." Exchange Act Release No. 11,532, 7 SEC Docket 403, 403 (July 11, 1975).

[2] Sands attempts to put his own spin on the actual course of events by arguing that he acquired Paul Kutik's position in the offering and Kutik invested before the deadline. His attempt fails. Because Kutik's check never cleared, his "position" in the offering amounted to zero. Sands' purchase of the 500 units, which Kutik had merely *wished to* purchase, occurred after the deadline and, therefore, after the Bancorp offering had already failed for inability to raise the $1,500,000 minimum.

[3] Sands' main contention, however, is that he had "bona fide" intentions at the time of his investment in the offering, and he did not, therefore, act with the requisite scienter. This argument goes very wide of the mark. The fact that Sands made a real investment is not determinative because that investment occurred after the Bancorp offering had already failed to satisfy the minimum requirement. If he wanted to invest, fine. But the other investors' funds should have been returned to them.

[4] In a mini-max offering, scienter is shown by a defendant's knowledge of the minimum requirement, and that the funds were retained even though the minimum amount was not raised. As the court said in *C.E. Carlson, Inc. v. SEC*, 859 F.2d 1429 (10th Cir. 1988):

> The SEC thus determined that both petitioners acted with scienter . . . . Scienter "refers to a mental state embracing intent to deceive, manipulate, or defraud." Proof of scienter may be satisfied by a showing of recklessness, or conduct which falls far short of the standard of ordinary care and which carries a danger of misleading purchasers such that petitioners knew or must have known of its propensity to mislead. The SEC found that petitioners were aware of the part-or-none provision, the requirement that two million shares be sold in a manner not inconsistent with a public distribution. Rather [than]

> wait for additional public sales or return the funds of subscribers, petitioners arranged for non-public sales to close the offering and then retained the funds.

Id. at 1435-36 (internal citations omitted); *see also Svalberg v. SEC*, 876 F.2d 181, 184 (D.C. Cir. 1989) (scienter is shown by "knowledge of what one is doing and the consequences of those actions"). When the $1,000,000 check from Paul Kutik was returned unpaid, Sands knew that Bancorp had failed to raise $1,500,000 as was required by the terms of the offering. But instead of refunding $688,000 to the investors, Sands retained those funds and proceeded to close the offering by investing $1,000,000 of his own money. That itself was fraudulent.

As the court pointed out in *Svalberg*, 876 F.2d at 183:

> The all-or-nothing provision serves not only to ensure that the issuing firm has sufficient funds to complete its project, but also to give investors some reasonable indication that they are paying a fair market price for their investments. Closing an all-or-none offering before the required minimum number of shares has been sold *to the public* is therefore fraudulent.

See also Banc One Capital Partners Corp. v. Kneipper, 67 F.3d 1187, 1193 (5th Cir. 1995) ("The sellers cannot avoid the requirements of [an all-or-none] provision by fraudulently creating the impression that the minimum has been met."); *C.E. Carlson, Inc.*, 859 F.2d at 1434; *A.J. White & Co. v. SEC*, 556 F.2d 619, 622-23 (1st Cir. 1977). Thus, regardless of his long term intentions at the time of the investment, the knowing retention of the monies that others invested into Bancorp's failed offering satisfied the scienter requirement, and the district court did not err in granting summary judgment on that issue.

(2) *The disgorgement order against Sands*

[5] The district court has broad equity powers to order the disgorgement of "ill-gotten gains" obtained through the violation of the securities laws. *See Clark*, 915 F.2d at 453; *see also SEC v. Fischbach Corp.*, 133 F.3d 170, 175 (2d Cir. 1997); *SEC v. First Jersey Sec. Inc.*, 101 F.3d 1450, 1474 (2d Cir. 1996), *cert. denied*, ___ U.S. ___, 118 S. Ct. 57, 139 L. Ed. 2d 21 (1997). Disgorgement is designed to deprive a wrongdoer of unjust enrichment, and to deter others from violating securities laws by making violations unprofitable. *See Hateley v. SEC*, 8 F.3d 653, 655 (9th Cir. 1993); *SEC v. Rind*, 991 F.2d 1486, 1491 (9th Cir. 1993). Further, where two or more individuals or entities collaborate or have a close relationship in engaging in the violations of the securities laws, they have been held jointly and severally liable for the disgorgement of illegally obtained proceeds. *See Hateley*, 8 F.3d at 656; *see also SEC v. Hughes Capital Corp.*, 124 F.3d 449, 455 (3d Cir. 1997); *First Jersey*, 101 F.3d at 1475. Sands played the principal role in the fraudulent activities in connection with the Bancorp offering. He fraudulently diverted $500,000 from PacVen and later invested his own funds in order to close an offering that had already failed to meet the minimum requirement. As the chairman of the board, the CEO and the majority shareholder of Bancorp, and as the president and the CEO of PacVen, Sands clearly enjoyed a "close relationship" with those corporate codefendants. *See Hughes*, 124 F.3d at 455. It was appropriate to hold Sands and his corporate codefendants jointly and severally liable for their jointly undertaken violations of the securities laws.

[6] Sands argues that he should not have been ordered to disgorge the proceeds of the offering because he received no personal financial benefit as a result of that offering. We reject the argument. The infusion of capital from the Bancorp offering put off a bank failure and enabled the Bank to remain in operation for two and a half more years. During that time, Sands engaged in what the district court's findings character-

ized as "milking the asset," by paying himself hundreds of thousands of dollars in salaries, commissions, and consulting, management and legal fees. The California state bank examiners determined that although Sands was not then an officer of the Bank, he retained control over the Bank and continued to extract sufficient income to service his heavy personal debt and to cover his living expenses. The FDIC inspector found that Sands was paying himself excessive compensation, which amounted to two or three times what a CEO of a comparable, well-managed institution would receive. The FDIC inspector also noted in his report that Sands "apparently could not afford to reduce his salary, pay on his loans, and maintain his standard of living." Thus, Sands received substantial personal benefit from the infusion of the illegally obtained proceeds from the Bancorp offering into the failing Bank, which justified the district court's order directing Sands to disgorge those proceeds.[6]

[7] Sands also claims that the district court ordered restitution instead of disgorgement, and that he was unfairly surprised and had no opportunity to raise defenses to that form of remedy. Sands' claim of unfair surprise is not supported by the record. Several pretrial pleadings filed by the SEC specifically requested that the court order Sands to disgorge the fraudulently retained proceeds of the Bancorp offering, and

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[6]The district court was not required to trace every dollar of the offering proceeds fraudulently retained by Sands. *See SEC v. Hughes Capital Corp.*, 917 F. Supp. 1080, 1085 (D.N.J. 1996), *aff'd* 124 F.3d 449 (3rd Cir. 1997). The amount he was ordered to disgorge had to be only "a reasonable approximation of profits causally connected to the violation." *First Jersey*, 101 F.3d at 1475 (citation omitted). Nor does the fact that Sands' scheme ultimately failed and he lost a $1,000,000 of his own funds release him from his obligations toward the defrauded investors. As Judge Friendly once stated in a securities manipulation case, there is "no reason why, in determining how much should be disgorged in a case where defendants have manipulated securities so as to mulct the public, the court must give them credit for the fact that they had not succeeded in unloading all their purchases at the time when the scheme collapsed." *SEC v. Commonwealth Chem. Sec. Inc.*, 574 F.2d 90, 102 (2d Cir. 1978).

that those proceeds be returned to the investors as restitution. Further, it is quite clear from the district court's conclusions of law that the remedy it granted was disgorgement rather than restitution. The fact that the district court directed that the disgorged funds be returned to the defrauded investors does not change the nature of the remedy. Once the primary purpose of disgorgement has been served by depriving the wrongdoer of ill-gotten gains, the district court has broad discretion in determining the disposition of the disgorged funds. *See Fischbach*, 133 F.3d at 175 ("Once the profits have been disgorged, it remains within the court's discretion to determine how and to whom the money will be distributed . . . ."); *SEC v. Huffman*, 996 F.2d 800, 803 (5th Cir. 1993) ("The district court has broad discretion in fashioning the equitable remedy of a disgorgement order."); *see also SEC v. Drexel Burnham Lambert, Inc.*, 956 F. Supp. 503, 507 (S.D.N.Y.), *aff'd*, 133 F.3d 170 (1997).

We need not engage in a rather scholastic argument about whether restitution and disgorgement are really just about the same thing. *Compare Tull v. United States*, 481 U.S. 412, 424, 107 S. Ct. 1831, 1839, 95 L. Ed. 2d 365 (1987) (they are to be equated), *and SEC v. Blatt*, 583 F.2d 1325, 1335 (5th Cir. 1978) (same), *with Texas American Oil Corp. v. United States Dep't of Energy*, 44 F.3d 1557, 1569-70 (Fed. Cir. 1995) (they are distinct concepts), *and Huffman*, 996 F.2d at 802 (same). The distinction drawn between the two remedies plays no role in this case because the district court determined that Sands and Bancorp were unjustly enriched by the amount that they fraudulently retained from the Bancorp offering and fraudulently diverted from the PacVen offering. The fact that the district court also ordered restitution does not affect the nature of the disgorgement remedy; nor does it render the disgorgement order improper. *See Fischbach*, 133 F.3d at 176 ("[I]t is normally within the district court's discretion to order that disgorged funds be used to compensate securities fraud victims . . . ."); *SEC v. World Gambling Corp.*, 555 F. Supp. 930, 934 (S.D.N.Y.), *aff'd*, 742 F.2d 1440 (2d Cir. 1983)

("[W]hile disgorgement has been said to serve more important interests that the compensation of investors, that principle is a far cry from the proposition that restitution is an improper end." (internal citation omitted.))

B. *OFFICER AND DIRECTOR BAR*

Sands earnestly argues that he should not have been "permanently and unconditionally prohibited from acting as an officer or director of any issuer required to file reports pursuant to Sections 12(b), 12(g) or 15(d) of the Securities Exchange Act of 1934 [15 U.S.C. §§ 781(b), (g) or 780(d)]." We have listened carefully to his monody, but we agree with the district court that protection of the public justifies the bar. In addition to the conduct we have detailed in the Background portion of this Opinion, Sands helped to orchestrate transactions involving Residual Interest Wrap Notes and Liberian Certificates of Deposit, which greatly and artificially inflated the value of the Bank.[7]

[8] The district court has broad equitable powers to fashion appropriate relief for violations of the federal securities laws, which include the power to order an officer and director bar. *See Posner,* 16 F.3d at 521; *see also SEC v. Patel,* 61 F.3d 137, 141 (2d Cir. 1995) (a district court has "substantial discretion" in deciding whether to impose an officer and director bar). In addition to the court's inherent equitable powers, the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (Remedies Act) authorizes the court to order an officer and director bar "if the person's conduct demonstrates substantial unfitness to serve as an officer or director." 15 U.S.C. § 78u(d)(2).[8] In determining whether

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[7]These transactions are described in *Sands I,* 902 F. Supp. at 1155-56, 1161-62. In *Sands I* the district court reserved judgment regarding issues of Sands' intent and wrongdoing. It later resolved those issues against him.

[8]We reject Sands' argument that the Remedies Act does not apply retroactively to conduct that occurred prior to its enactment. The Act merely

to order the bar, a court may consider: "(1) the 'egregiousness' of the underlying securities law violation; (2) the defendant's 'repeat offender' status; (3) the defendant's 'role' or position when he engaged in the fraud; (4) the defendant's degree of scienter; (5) the defendant's economic stake in the violation; and (6) the likelihood that misconduct will recur." *Patel*, 61 F.3d at 141.

[9] The district court considered those factors, and found that Sands' "securities violations are egregious; he caused the collapse of a federally insured bank; he attempted to stymie banking regulators from doing their jobs; he is a recidivist; and the fraudulent conduct he committed occurred while serving in a corporate or fiduciary capacity." The district court also found that Sands had a high level of scienter, that he engaged in ongoing and recurrent violations, that he had failed to assume any responsibility for his violations of law, that he utterly failed to recognize the wrongful nature of his conduct, and that there was a strong likelihood of future violations. We see no error in those detailed findings. Indeed, they describe Sands' actions perfectly and are sufficient to support the court's discretionary decision to protect the public interest by barring Sands from serving as an officer or director of a public company. We think we need only briefly comment on his audacious argument that the officer and director bar is against the public interest because it will interfere with his active involvement in charitable activities. Perhaps he is right that charities will not want to place him in positions of high visibility and prestige. If so, and if Sands does have a genuine interest in doing charitable works, we are certain that he can continue his charitable involvement in a less prestigious, but

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codified the equitable authority to impose officer and director bar which the courts already possessed and exercised. *See SEC v. Drexel Burnham Lambert Inc.*, 837 F. Supp. 587, 613 (S.D.N.Y. 1993), *aff'd*, 16 F.3d 520 (2d Cir. 1994). Furthermore, the district court in this case relied on the alternative basis for the injunction — its equitable powers to fashion appropriate relief for violations of the federal securities laws. *See Posner*, 16 F.3d at 521.

just as worthy, capacity. We touch on this argument because it underscores the purblindness of Sands and the perspicacity of the district court.

CONCLUSION

Sands, a sophisticated businessman and a lawyer, has engaged in numerous activities in violation of the securities laws and basic notions of right and wrong. He perpetuated a number of frauds upon investors and regulators. We need not sort out whether his principles are just plain wrong, or whether he is afflicted with akrasia, or whether there is some other explanation for his actions. What is clear is that he, along with Bancorp and PacVen, must disgorge the amounts that the unwitting investors were relieved of. Equally clear, the district court properly barred him from assuming a position from which he could inflict similar wrongs in the future.

AFFIRMED.

APPENDIX B — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA DENYING DEFENDANT'S MOTION FOR SUMMARY JUDGMENT, GRANTING IN PART AND DENYING IN PART PLAINTIFF'S CROSS-MOTION FOR SUMMARY JUDGMENT, AND GRANTING IN PART AND DENYING IN PART MOTIONS TO STRIKE CERTAIN AFFIRMATIVE DEFENSES DATED JULY 26, 1995

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff,

v.

Leonard S. SANDS, et al., Defendants.

No. CV 93-7510 JGD.
United States District Court,
C.D. California.
July 26, 1995.

* * *

ORDER DENYING DEFENDANT'S MOTION FOR SUMMARY JUDGMENT, GRANTING IN PART AND DENYING IN PART PLAINTIFF'S CROSS-MOTION FOR SUMMARY JUDGMENT, AND GRANTING IN PART AND DENYING IN PART MOTIONS TO STRIKE CERTAIN AFFIRMATIVE DEFENSES

DAVIES, District Judge.

On July 10, 1995, the following motions were argued: (1) Defendant Sands' Motion for Summary Judgment; (2) Plaintiff's Cross-Motion for Summary Judgment; (3) Plaintiff's

Appendix B

Motion to Strike Affirmative Defenses of Defendants Sands, Bancorp, and PacVen; and (4) Plaintiff's Motion to Strike Certain Affirmative Defenses of Defendant Knapp. Having considered the parties' written submissions, and the oral argument of counsel, the Court hereby DENIES Defendant Sands' motion for summary judgment, GRANTS in part and DENIES in part the Plaintiff's motion for summary judgment, GRANTS in part and DENIES in part the motion to strike the affirmative defenses of Sands, Bancorp, and PacVen, and GRANTS the motion to strike certain affirmative defenses of Defendant Knapp.

FACTS

This civil enforcement action arises from the alleged violation of certain securities laws in conjunction with the management and operation of Defendant First Pacific Bancorp ("Bancorp"). At all relevant times, Defendant Leonard S. Sands was the chairman of the board and chief executive officer of Bancorp. Bancorp is a bank holding company incorporated under the laws of the State of Delaware in July 1981. Sands owned 54.6% of Bancorp's common stock. Prior to August 1990, Sands was director and corporate counsel of First Pacific Bank, Inc. ("FPB"), the sole bank owned by Bancorp. FPB became Bancorp's wholly owned subsidiary in October 1982. FPB was Bancorp's major asset. Sands was also the president and CEO of Defendant PacVen, Inc., a "blank check" corporation incorporated under the laws of Nevada. PacVen was formed for the purpose of merging with or acquiring other companies.

Defendant Charles W. Knapp and Sands were business associates. Defendant Berrien E. Moore was a member of the Bancorp board of directors and an executive vice-president of

the Bank.[1] Defendant Daniel S. Geiger was a vice-president of FPB. Defendant Mulc Raj Dass is a citizen of India, and resides in Texas. Defendant Apex Investment Securities, Ltd. was a Panamanian corporation owned by Dass.

Bancorp's stock was publicly traded in the over-the-counter market, except for a period of suspension from June 1989 to April 1990. The Bank was taken over by federal regulators in August 1990.

The Securities and Exchange Commission ("SEC") charges the Defendants with violations of the anti-fraud provisions of certain securities laws. The claims against Defendants Bancorp and Sands may be categorized as follows: (1) failure to return funds and disclose material information to investors in connection with stock offerings by Bancorp and PacVen in 1987; (2) improper classification and disclosure of Residual Interest Wrap Notes in financial statements filed with the SEC; and (3) improper booking on Bancorp's financial statements of certain certificates of deposit issued by the Nation Bank of Liberia which were unfunded and uncollectible.

The Bancorp Stock Offering

In April 1987, Bancorp commenced a public offering (hereafter, the "Bancorp offering") by filing an amended registration statement and prospectus with the SEC. The prospectus became effective May 14, 1987. The Bancorp offering was underwritten by P.J. Jameson Company, Inc. The amended registration statement provided for a "mini-max" offering. In a mini-max offering, the offering company is

1. On April 6, 1994, Defendant Berrien E. Moore and the SEC stipulated to a permanent injunction and final judgment.

required to sell a minimum number of shares on an all or none basis. Once the minimum is reached, the balance of shares are sold on a best-efforts basis.

Bancorp offered a minimum of 750 "units" on an all or none basis. A unit consisted of (1) 500 shares of common stock; (2) warrants to purchase 250 additional shares of common stock; and (3) a 5-year $1,000 convertible debenture at 9 1/4 percent interest. Each unit was sold for $2,000. Under the terms of the prospectus, Bancorp was required to sell at least 750 units by August 12, 1987. The underwriter had discretion to extend the deadline by 60 days, and did so extend the deadline to October 10, 1987. Proceeds from the sale were to be held in escrow until the requisite number of units were sold. The prospectus stated that if 750 units were sold, i.e. $1.5 million was raised, Bancorp would have the right to sell up to 1,275 units on a best efforts basis. If at least 750 units were not sold within the offering period, the offering would be cancelled and the investors' funds would be returned.

On October 9, 1987, $1,688,000 was forwarded to the escrow agent for investment in the Bancorp offering. Of these funds, $1 million was in the form of a personal check written by Paul Kutik, and drawn on the Bank of Montreal. This check was later returned unpaid. Bancorp did not sell the minimum number of units by October 10, 1987, and it failed to refund the investors' funds. Sands informed the Federal Reserve Board of San Francisco that the minimum portion of the Bancorp offering had been completed. Bancorp continued with the offering. On December 30, 1987, Sands purchased 500 units, paying $1 million of his own funds. Sands asserts that he acquired Kutik's position when the latter's check was returned unpaid. Of the remaining $688,000 raised in the offering, $500,000 was invested by Trafalgar Holdings, Inc., a company

controlled by Defendant Knapp. The parties dispute whether the $500,000 was raised in a public offering conducted by PacVen and indirectly invested by Sands in the Bancorp offering. The remaining $188,000 was raised by personal investors.

On December 31, 1987, Bancorp declared the offering closed. The escrow agent wire transferred $1,688,000, less fees, to Bancorp. The $688,000 acquired from investors other than Sands was never returned to the investors.

The PacVen Stock Offering

PacVen was a "blind pool" company which was formed for the purpose of merging with and acquiring existing companies. In April 1987, PacVen engaged in a public offering of common stock. It proposed to "allocate the proceeds from the offering, together with its existing capital, toward seeking, investigating, and acquiring an interest or becoming engaged in a business opportunity." PacVen Registration Statement at 16. The registration statement for the public offering stated:

> All funds not being utilized by the Company for its proposed business will be held in interest bearing accounts or investments in commercial financial institutions until such time as it appears that they will be required.

Id. The PacVen offering raised approximately $541,000. On July 27, 1987, PacVen filed with the SEC a Form S-R stating that the proceeds from the 1987 stock offering had been placed in "short term bank and other deposits." Form S-R at 4. The parties dispute whether the Form S-R misrepresented the actual

use of the proceeds. The SEC alleges that PacVen indirectly invested the proceeds in the 1987 Bancorp offering. PacVen did not file a final Form S-R disclosing the disposition of the offering proceeds.

Residual Interest Wrap Notes

In 1989, Bancorp acquired $5,618,000 of Residual Interest Wrap Notes ("RIWNs"). Bancorp recorded the RIWNs as assets on its balance sheet. A RIWN was a secondary financing instrument. It was used in the sale of low income apartment projects sponsored by the Department of Housing and Urban Development ("HUD"). The interest on the note accrued over the note's term, but no interest was paid until the underlying property was sold or refinanced. When the property was sold or refinanced, the RIWN was paid, but only if the sale or refinancing yielded sufficient funds to first pay off all primary financing. The value of the RIWN was thus tied to the appreciation of the underlying property.

The RIWNs presented great risk to their owners. The owner was entitled to interest payments at the time the primary financing of the property was extinguished. The RIWNs were not collateralized by the underlying properties. They provided additional leverage on the property to increase equity yield. Bancorp could liquidate the RIWNS only if HUD approved repayment or refinancing of the underlying property. In 1990, HUD instituted a moratorium on such repayments and refinancings.

The Liberian Certificates of Deposit

In 1989, Bancorp owned six certificates of deposit issued by the National Bank of Liberia (the "Liberian CDs"). On its

balance sheet, Bancorp recorded the Liberian CDs as $3 million in assets. The Liberian CDs were issued to Defendant Apex Investment Securities, Inc. They were not funded when issued. Apex was to lodge the certificates in an account designated by the National Bank of Liberia ("NBL"), at which time the CDs would be funded. NBL informed Bancorp and Sands that it would not honor the Liberian CDs unless they were funded. Bancorp acquired the Liberian CDs in exchange for Bancorp preferred stock.

In December 1989, NBL informed Bancorp that the Liberian CDs had not been funded. Sands and other Bancorp officials received several letters from NBL stating that the CDs would not be negotiated unless funded and that they were "worthless." Nonetheless, Bancorp recorded the Liberian CDs as assets on forms filed with the SEC.

The Amended Complaint

On December 13, 1993, the SEC filed this action alleging violations of the anti-fraud and disclosure provisions of numerous federal securities laws. The SEC seeks a permanent injunction prohibiting Defendants from violating said securities laws and requiring disgorgement of unlawful profits.

On January 31, 1994, Defendants Sands and Bancorp filed answers and a cross claim. On March 21, 1994, the Court granted the SEC's motion to dismiss the cross claim against defendants Mulc Raj Dass and Apex Investment Securities, Ltd. The Court found that private parties may not file cross claims against each other in an SEC enforcement action. The Court further granted in part the SEC's motion to strike certain affirmative defenses.

Appendix B

On November 14, 1994, the SEC filed an amended complaint. It elected to do so because of a recent Supreme Court decision that held there is no aiding and abetting liability under Section 10(b) of the Securities and Exchange Act of 1934, and to plead the fraud allegations with particularity. The amended complaint alleges six claims.

Specifically, the SEC alleges the following in the amended complaint: (1) by omitting material facts in the Bancorp offering, Bancorp, Sands, and Knapp directly or indirectly violated Section 17(a) of the Securities Act of 1933 (the "1933 Act") and Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act"); (2) PacVen and Sands violated Section 10(b) of the 1934 Act and Rule 10b-5, and PacVen violated Section 15(d) of the 1934 Act and Rules 12b-20, 15d-1, and 15d-13 by filing reports containing materially false and misleading information; (3) PacVen violated Rule 463 of Regulation C under the 1933 Act by failing to file Supplemental Reports on Form S-R; (4) PacVen and Sands violated Section 13(b)(2)(A) of the 1934 Act by failing to maintain accurate books and records; (5) Sands violated Sections 13(d) and 16(a) of the 1934 Act and Rules 13d-2 and 16a-3 by failing to file Amended Schedules 13D and Form 4; and (6) Bancorp and Sands violated Section 10(b) of the 1934 Act and Rule 10b-5, Bancorp violated Section 13(a) of the 1934 Act and Rules 12b-20 and 13a-13, and Sands violated Section 20(a) of the 1934 Act, by making materially false and misleading statements in periodic reports involving the RIWNs and the Liberian CDs.

On February 24, 1995, Defendant Sands filed a motion for summary judgment. The motion was continued because the SEC requested additional time to conduct discovery on the issue of scienter. On May 22, 1995, the SEC filed a motion to strike

certain affirmative defenses. On May 23, 1995, the SEC filed a cross- motion for partial summary judgment. It seeks summary judgment on the first, third, fifth, and sixth claims.

DISCUSSION

I. Defendant Sands' Motion for Summary Judgment

A. Summary Judgment Standard

The Federal Rules of Civil Procedure provide for summary judgment if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c). The Supreme Court clarified the standard for summary judgment in three important cases. See Celotex Corporation v. Catrett, 477 U.S. 317, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986); Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986); Matsushita Electric Industrial Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986).

The moving party bears the initial burden of demonstrating the absence of a genuine issue of material fact for trial. Anderson, 477 U.S. at 256, 106 S.Ct. at 2514. Whether a fact is material is determined by looking to the governing substantive law; a fact is material if it may affect the outcome of the suit. Id. at 248, 106 S.Ct. at 2510. If the moving party seeks summary adjudication with respect to a claim or defense upon which it bears the burden of proof at trial, its burden must be satisfied by affirmative admissible evidence. By contrast, when the non-moving party bears the burden of proving the claim or defense, the moving party can meet its burden by pointing out

the absence of evidence from the non-moving party. The moving party need not disprove the other party's case. See Celotex, 477 U.S. at 325, 106 S.Ct. at 2553-54; see also Schwarzer, Tashima & Wagstaffe, Federal Civil Procedure Before Trial §§ 14:123-141 (1995).

When the moving party meets its burden, the "adverse party may not rest upon the mere allegations or denials of the adverse party's pleadings, but the adverse party's response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial." Fed.R.Civ.P. Rule 56(e). Summary judgment will be entered against the non-moving party, when appropriate, if that party does not present these specific facts. Id.

In assessing whether the non-moving party has raised a genuine issue, its evidence is to be believed, and all justifiable inferences are to be drawn in its favor. Anderson, 477 U.S. at 255, 106 S.Ct. at 2513-14 (citing Adickes v. S.H. Kress and Company, 398 U.S. 144, 90 S.Ct. 1598, 26 L.Ed.2d 142 (1970)). Nonetheless, "the mere existence of a scintilla of evidence" is insufficient. Id. at 252, 106 S.Ct. at 2512. As the Court explained in Matsushita, 475 U.S. at 586-87, 106 S.Ct. at 1355-56:

When the moving party has carried its burden under Rule 56(c), its opponent must do more than simply show that there is some metaphysical doubt as to the material facts. . . . Where the record taken as a whole could not lead a rational trier of fact to find for the nonmoving party, there is no "genuine issue for trial."

Appendix B

B. The Remedies Sought Are Proper

Sands argues that he is entitled to summary judgment because the equitable relief sought by the SEC is improper. In the prayer for relief, the SEC requests the Court to (1) find that the Defendants violated certain sections of the 1933 Act, the 1934 Act, and rules promulgated thereunder; (2) permanently restrain and enjoin the Defendants from further violations of securities laws; (3) order Defendant Sands to disgorge all profits received and losses avoided as a result of the securities laws violations; and (4) permanently prohibit Defendant Sands from acting as an officer or director of any securities issuer. Complaint at 29-31.

1. Disgorgement is a Remedy

The SEC seeks an order requiring Sands to disgorge all profits earned and losses avoided as a result of the securities violations alleged in the complaint. When ordered by a court in a securities action, disgorgement is designed to deprive the defendant of his "ill-gotten gains and prevent unjust enrichment." Hateley v. SEC, 8 F.3d 653, 655 (9th Cir.1993).

In response to Sands' first set of interrogatories, the SEC asserts that it seeks to recover $500,000 that PacVen raised in a public offering and indirectly invested in the Bancorp offering. The SEC further requests that the Defendants disgorge the $188,000 invested by the public in the Bancorp offering. Def.Exh. 2 at 49.[2] Sands argues that he earned no profits as a

2. Defendant Sands' Exhibits are attached to the Statement of Uncontroverted Facts and Conclusions of Law filed concurrently with the motion for summary judgment. Page numbers refer to the cumulative pages in the package of exhibits. Exhibits filed by the SEC in opposition to Sands' summary judgment motion are attached to Plaintiff's Rule 56 Statement of Facts Genuinely In Dispute, filed March 15, 1995.

result of the alleged securities violations. The complaint does not even allege that Sands personally profited from the allegedly unlawful actions. Motion at 6. He further argues that the Supreme Court has eliminated the SEC's implied remedy of disgorgement, and statutes expressly providing for such a remedy cannot be retroactively applied to the instant action.

The SEC has met its burden of showing that whether Sands obtained any "ill-gotten gains" from the 1987 offering by FPB is a triable issue of fact. In order to seek disgorgement as a remedy, the SEC must show that Sands profited from the transaction or avoided losses "as a result of the illegal conduct." Complaint at 31. The terms of the Bancorp mini-max offering required Bancorp to raise a minimum of $1.5 million from bona fide purchasers or be required to return to investors all funds raised. SEC Exh. 2 at 20. Bancorp attempted to raise between $1.5 million and $2.55 million to enable the corporation to reorganize and eliminate FPB's capital impairment. Bancorp Prospectus, Def.Exh. 20 at 173. Sands owned 54.6% of Bancorp, and was its largest shareholder. Id. at 21. Sands thus stood to avoid losses if FPB was able to raise funds in the 1987 offering sufficient to enable it to reorganize and continue to operate.

Sands correctly asserts that the SEC has the burden of proving at trial that he profited through the Bancorp offering. In moving for summary judgment, however, Sands has the burden of producing admissible evidence showing that he earned no profits and avoided no losses as a result of the Bancorp offering. The SEC has met its burden by showing that Bancorp raised $688,000 in the offering. Sands, on the other hand, has produced no evidence in support of his assertion that he neither profited nor avoided losses in the Bancorp offering. As Bancorp's majority shareholder, he stood to avoid losses

by raising capital for Bancorp. Whether Sands avoided any losses or realized some profit in the Bancorp offering is an issue to be determined at trial. Sands has not shown that the remedy is unavailable as a matter of law.

Nor is Sands correct in asserting that the Supreme Court has determined that disgorgement is unavailable in private actions arising under the securities laws. In Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 114 S.Ct. 1439, 128 L.Ed.2d 119 (1994), the Court held that private litigants may not assert a claim for aiding and abetting under Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b). The Central Bank decision does not "renounce[ ] the once predominant view that courts may invoke whatever rights and remedies they deem appropriate to effectuate the purposes of the securities laws." Motion at 8. The Court did not address the issue of remedies or overrule its prior decisions that provide federal courts with the power to award appropriate relief, including disgorgement, when the defendant violates a federal statute. See Franklin v. Gwinnett County Public Schools, 503 U.S. 60, 69, 112 S.Ct. 1028, 1035, 117 L.Ed.2d 208 (1992) (upholding district court's imposition of an equitable remedy so long as it is presented with a violation of a federal statute).

2. Injunctive Relief is not Barred as a Matter of Law

The SEC seeks an order enjoining the Defendants from violating the securities laws. The SEC also requests the Court to prohibit Sands from acting as an officer or director of any issuer of securities required to file certain reports under the 1934 Act. Complaint at 31.

Section 21(d)(2) of the 1934 Act provides that "[w]henever it shall appear to the [SEC] that any person is engaged or about

to engage in acts or practices constituting a violation of any provision of the chapter," or the rules promulgated thereunder, it may bring an action in district court to "enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond." 15 U.S.C. § 78u(d)(1). A district court may prohibit the defendant from "acting as an officer or director of any issuer" of a class of securities as defined by the statute if the defendant's conduct "demonstrates substantial unfitness" to serve as an officer or director. 15 U.S.C. § 78u(d)(2).

Sands contends that it would be improper for the Court to bar him from serving as an officer or director or enjoin him from future violations of the securities laws. The SEC has not shown that Sands is engaged or likely to engage in further violations. The requested relief is also impermissibly overbroad.

As Sands points out, in order to obtain injunctive relief the SEC has the burden of showing he is reasonably likely to violate the securities laws in the future. SEC v. Murphy, 626 F.2d 633, 655 (9th Cir.1980). The fact that the defendant is not currently engaged in securities violations does not preclude an injunction. In predicting the likelihood of future violations, the court looks to the totality of the circumstances surrounding the defendant and his violations. Factors to be considered include (1) the degree of scienter involved; (2) the isolated or recurrent nature of the infraction; (3) the defendant's recognition of the wrongful nature of his conduct; (4) the likelihood, because of defendant's professional occupation, that future violations might occur; and (5) the sincerity of the defendant's assurances against future violations. Id.

The Court cannot find as a matter of law that injunctive relief is unavailable in the instant action. As described below,

the SEC has produced evidence sufficient to find that Sands operated with the requisite intent to constitute a violation of the securities laws. The evidence is that over a two-year period Bancorp and Sands filed numerous forms with the SEC that contained material misrepresentations. The SEC has produced evidence that Sands misrepresented the value of Bancorp's assets while he was an officer and director of that corporation. The evidence supports a finding that Sands was attempting to preserve his investment in Bancorp.

Sands' present status at Bancorp and PacVen is unclear. He may be able to commit future violations, as there is no evidence that he is unable to resume operation of Bancorp or PacVen. This is true given that Sands exhibits no remorse and denies acting in bad faith. He makes no assurances against future violations. The SEC bears the burden of proving the likelihood of future violations of the securities laws. It has produced evidence sufficient to survive summary judgment and present such evidence at trial.

C. Scienter

The final argument in support of Sands' motion for summary judgment is that he acted in good faith. Sands argues he did not possess the requisite scienter to support a finding that he violated the securities laws. To establish liability under the 1934 Act, a plaintiff must show the defendant acted with scienter, "a mental state embracing intent to deceive, manipulate, or defraud." In re Worlds of Wonder Securities Litigation, 35 F.3d 1407, 1424 (9th Cir.1994) (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n. 12, 96 S.Ct. 1375, 1381 n. 12, 47 L.Ed.2d 668 (1976)). Scienter must be shown in actions brought by the SEC seeking injunctive relief. Aaron v.

SEC, 446 U.S. 680, 691, 100 S.Ct. 1945, 1953, 64 L.Ed.2d 611 (1980). A defendant in a securities law case is entitled to summary judgment if no reasonable jury could find that the defendant acted with the requisite scienter. Worlds of Wonder, 35 F.3d at 1412.

The SEC charges Sands with, inter alia, violations of section 17(a) of the 1933 Act, 15 U.S.C. § 77q(a), and section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), for omitting material facts in connection with the Bancorp mini-max offering. As evidence of scienter, the SEC alleges Sands (1) knew the Bancorp mini-max offering would not close, and $188,000 in investor funds would have to be refunded, unless he invested in the offering; (2) decided to use the PacVen offering proceeds to finance the Bancorp mini-max offering; (3) knowingly allowed the Bancorp mini-max offering to close when $1.5 million of the funding was obtained from non-bona fide purchasers; and (4) caused all or a portion of the proceeds raised in the PacVen offering to be "downstreamed" to FPB in order to improve the bank's capital to asset ratio. Complaint, ¶ 37.

1. Disclosure of Sands' $1 Million Investment

Sands invested $1 million of borrowed funds in Bancorp in order to fund the 1987 offering. Sands characterizes the SEC's complaint as objecting to the fact that Sands failed to disclose that he had invested his own funds in the Bancorp offering. Motion at 22. He responds by stating that the lawyers and other professionals involved in the 1987 offering were informed that he invested his own funds. Sands later submitted "the appropriate filings concerning [his] investment" when concerns were raised as to full disclosure. Id. at 23.

The SEC, however, objects to more than mere non-disclosure. Under the terms of the prospectus issued with the mini-max offering, Bancorp was required to sell $1.5 million in Bancorp units to bona fide purchasers. A sale to a control person such as Sands in not "bona fide." In re F.D. Roberts Securities, Inc., SEC Rel. No. 34-26389, 42 S.C.C. Docket 694 (Dec. 22, 1988). Thus, the offering failed, and Bancorp was required to return the investors' funds. SEC Exh. 2 at 122. Sands and Bancorp committed fraud and rendered the prospectus materially false by not returning investors' funds when Bancorp did not raise $1.5 million from bona fide sales. Sands' failure to disclose the investment is only one aspect of the alleged securities violations. Op. at 9 n. 7.

As further evidence of scienter, the SEC has produced evidence of Sands' failure to properly disclose to the SEC and other investors his $1 million investment in the Bancorp offering. When Sands purchased $1 million of the $1,688,000 in securities issued in the 1987 offering, he was required to file a Form 4 with the SEC within 10 days. 15 U.S.C. § 78p(a). This document would inform the SEC that his stake in Bancorp had increased. The offering closed on December 30, 1987, SEC Exh. 3, but Sands did not file a Form 4 until September 1989. Def.Exh. 8. Further, Sands did not file Bancorp's 1988 annual reports until April 16, 1990. Said report disclosed Sands' $1 million investment in Bancorp. SEC Exh. 27.

On May 3, 1989, A. Randall Thoman, a Bancorp accountant, wrote a memorandum addressing the allowance for loan losses relative to loans classified by FDIC examiners. The memorandum states that on May 2, 1989, Sands first informed the accountants that he had purchased some of the units sold in the Bancorp offering. Sands purchased the units when he

determined that the offering would be terminated unless he did so. SEC Exh. 54 at 28. Sands stated that he did not know if he had filed a Form 4 in connection with his purchase of the securities. Jehu Hand, an attorney representing FPB, stated that the transaction required the filing of a Form 4, but that "for some time, we didn't know that [Sands] had bought the units." Id.

Rowland W. Day is the attorney who represented the underwriter in the 1987 Bancorp offering. He also represented PacVen in its 1987 stock offering. Day asserts that Sands did not inform him that he invested his own funds into the Bancorp offering, and never sought Day's advice regarding disclosure of the investment. SEC Exh. 55 at 31. Day contradicts Sands' statement that all lawyers and professionals were aware that Sands invested $1 million of his own funds in the offering. As evidence of Sands' scienter, Day asserts that "Sands could not have relied on my advice in failing to disclose . . . that he buttressed the Bancorp offering with $1 million he invested personally, as he never sought my advice on these matters." Id. at 32. Thus, the issue of whether Sands unlawfully avoided disclosing the use of his own money to fund the Bancorp offering presents a triable issue of fact.

2. PacVen's Acquisition of Bancorp Securities

The complaint alleges that on October 9, 1987, PacVen, at Sands' direction, transferred $500,000 of its offering proceeds to 109 Wilshire Corporation, a company controlled by Charles Knapp. In exchange, Trafalgar Holdings, Inc. ("Trafalgar"), also controlled by Knapp, issued to PacVen an unsecured note for $500,000. Knapp invested PacVen's $500,000 in the Bancorp mini-max offering. Complaint, ¶ 30. Sands thus

"indirectly" invested an additional $500,000 in the Bancorp offering.

The SEC contends that PacVen violated the securities laws when it transferred $500,000 to Knapp and said funds were invested in the Bancorp offering. This was an unauthorized use of PacVen's offering proceeds. PacVen did not disclose the transfer or the investment in forms filed with the SEC. Instead, PacVen made the "materially false and misleading statement" that PacVen had loaned the proceeds to an unrelated party. Complaint, ¶ 45.

Sands argues that he did not cause PacVen's offering proceeds to be used to fund the Bancorp offering. Sands contends that the SEC can provide no evidence that Knapp's investment in the Bancorp offering was inconsistent with legitimate business purposes. Nor can it support the allegation that Knapp and Sands conspired to "funnel" PacVen's proceeds into Bancorp. Motion at 25-26. Sands suggests that PacVen purchased a promissory note from Trafalgar in a transaction contemporaneous with, but unrelated to, Knapp's investment in the mini-max offering. The SEC "simply assumes the worst" because both transactions were in the amount of $500,000. Id. at 26.

PacVen raised approximately $541,000 in a public offering conducted in May and June of 1987. Def.Exh. 22. The prospectus issued by PacVen required PacVen to hold the funds raised in the offering in an interest bearing account or in investments in "commercial financial institutions" until they could be used to finance mergers between PacVen and other companies. Instead, PacVen used the funds to purchase a short term note from Trafalgar in October 1987. Def.Exh. 24. The

use of the funds thus violated the terms of the prospectus. SEC Exh. 58 at 41. PacVen's Form S-R, filed with the SEC in August 1990, states that funds raised by PacVen were placed in short term bank and other deposits. SEC Exh. 59 at 44. As discussed below, Sands made material misrepresentations on the Forms S-R filed with the SEC.

The SEC has produced handwritten notes taken by Robert Johnson in a meeting with Sands, Knapp, and four other men involved in a potential merger between PacVen and Paperulers, Inc. The merger was agreed upon in 1988 but never consummated. Def.Exh. 10. In the meeting, Sands stated that the funds that purchased the note issued by Trafalgar were used to purchase FPB stock. SEC Exh. 15 at 39-40. That PacVen used the funds raised in its stock offering to purchase Bancorp securities is also supported by a May 5, 1989 memorandum written by A. Randall Thoman. The memorandum states that Bancorp's accountants did not know that Sands had personally invested in the Bancorp offering until he prepared the 1987 Form 10-K. SEC Exh. 14 at 34-35. The SEC has met its burden of showing that whether Sands used the $500,000 PacVen loaned to Trafalgar to indirectly purchase Bancorp securities is a triable issue of fact.

3. The Liberian CDs and RIWNs

The sixth cause of action alleges securities laws violations arising from Sands' and Bancorp's disclosure and improper booking of certificates of deposit issued by the National Bank of Liberia ("Liberian CDs") and Residual Interest Wrap Notes ("RIWNs"). The SEC charges Sands with making materially false statements regarding the RIWNs and Liberian CDs in Bancorp's 1989 10-K and March 10-Q reports filed with the

SEC. The false statements allegedly constitute violations of section 13(a) of the 1934 Act, 15 U.S.C. § 78m(a), and Rules 12b-20 and 13a-13 promulgated thereunder.

Apex Investment Securities, Inc. ("Apex") acquired 40 certificates of deposit from the government of Liberia. The majority of the CDs were deposited with FPB which acted as an escrow agent. Subsequently, Bancorp purchased six of the CDs from Apex. The six CDs had a face amount of $3,000,000. Apex purchased 100 shares of Bancorp preferred stock in exchange for the Liberian CDs. Def.Exhs. 36-37. At issue is whether the CDs had any value and whether Sands, in financial disclosures filed with the SEC, misrepresented the way the CDs were acquired, booked, and valued.

Sands argues that at all times he acted in good faith. He believed that the Liberian CDs and RIWNs were valuable instruments.[3] Sands and Bancorp "took affirmative steps to assure themselves that the CDs had been properly and validly issued by the NBL," and were informed that the Liberian CDs were purchased by Apex for good consideration. Motion at 27-28. In June 1990, Sands was informed of the results of an investigation into the CDs conducted by the Federal Reserve Bank. The Federal Reserve stated that the CDs sold to Apex were not issued in connection with an actual deposit of funds in the NBL. They were created to be sold by Apex and "funded" after such sales were complete. The NBL did not honor its obligations and the CDs thus had no value. Def.Exh. 43 at 397.

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3. The SEC has produced evidence sufficient to survive summary judgment relating to both the Liberian CDs and the RIWNs. Since the evidence of unlawful acts pertaining to either "asset" is enough to deny Sands' motion, the following discussion pertains to the Liberian CDs only.

Sands contends that when he learned the CDs had no value, Bancorp wrote off the CDs on its books within eight days. Motion at 28, Def.Exh. 44.

The evidence, however, supports a finding that Sands knew the CDs were unfunded as early as December 1989. In a letter written by the Deputy Governor of the National Bank of Liberia to First Pacific Bank, FPB was informed that it should contact Apex to negotiate funding of the CDs. It was clear that the CDs were unfunded and that the National Bank of Liberia had not warranted that funding would occur. SEC Exh. 20. On December 13, 1989, FPB wrote to Apex regarding ways to "facilitate the funding of the Certificates of Deposit." SEC Exh. 21. The SEC asserts that Sands had been informed that the CDs were unfunded when he visited Liberia on December 7 and 8, 1987. SEC Supplement, ¶ 14.

On January 17, 1990, the NBL wrote to Apex expressing frustration in the fact that the CDs had not yet been funded. Apex had informed the NBL that payment instructions were issued in November 1989. The Liberian bank requested Apex to return its original certificates because the January 15, 1990 deadline for funding the CDs had expired and "it [was] quite apparent [Apex was] unable to arrange the funding of the[ ] Certificates." In a letter dated April 5, 1990, the NBL informed Sands that it would not honor the CDs. They had not been funded as required by an agreement entered between Apex and the NBL when the Liberian CDs were issued.

Bancorp filed a 1989 Form 10-K on April 16, 1990 that included the CDs as assets. SEC Exh. 28 at 71. The booking of the CDs as assets was an apparent attempt to ignore the high probability that the CDs had no value and could not be collected.

Sands' signature does not appear on the 10-K. But it is undisputed Sands was a controlling person of Bancorp as defined in 15 U.S.C. § 78t(a). Whether Sands intentionally misrepresented the value of the Liberian CDs on the Form 10-K is a triable issue of fact.

II. Plaintiff SEC's Cross Motion for Partial Summary Judgment

In its cross-motion for summary judgment, the SEC moves for partial summary judgment on the following claims: (1) Claim 1, based on the fact Sands and Bancorp did not refund the money invested in the mini-max offering even though Bancorp failed to sell the minimum number of units of Bancorp stock; (2) Claim 3, because PacVen violated Rule 463 of Regulation C when PacVen did not file an interim and final supplement to its Form S-R following the 1987 stock offering; Claim 5, because Sands failed to file a Form 4 with the SEC when he used his own funds to purchase securities in the 1987 Bancorp offering; and Claim 6, based on the fact that Bancorp filed reports with the SEC which contained false and misleading statements regarding the value of the RIWNs and Liberian CDs.

A. Claim 1: Failure to Refund Money to Investors

The SEC moves for summary judgment against Sands and Bancorp on the first claim. The first claim charges the Defendants with securities fraud for failing to refund investors' funds. This rendered materially false the prospectus issued with the 1987 Bancorp mini-max offering.

The SEC alleges violation of section 17(a) of the 1933 Act, 15 U.S.C. § 77q(a), and Section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), and rules 10b-5 and 10b-9 promulgated thereunder.

These sections prohibit use of "any manipulative or deceptive device or contrivance" in the purchase, offer, and/or sale of securities in interstate commerce. Rule 10b-5, 17 C.F.R. § 240.10b- 5, prohibits in connection with the purchase or sale of any security the employment of any "device, scheme or artifice to defraud," the making of any "untrue statement of material fact," and any act that "operates or would operate as a fraud or deceit upon any person."

Rule 10b-9 prohibits the making of a misrepresentation in connection with a mini-max offering. It requires the issuer in such an offering to adhere to disclosures in the prospectus. The rule states in relevant part:

> (a) It shall constitute a "manipulative or deceptive device or contrivance," as used in section 10(b) of the Act, for any person, directly or indirectly, in connection with the offer or sale of any security, to make any representation:
>
> . . . .
>
> (2) To the effect the security is being offered or sold on any other basis whereby all or part of the consideration paid for any such security will be refunded to the purchaser if all or some of the securities are not sold, unless the security is part of an offering or distribution being made on the condition that all or a specified part of the consideration paid for such security will be promptly refunded to the purchaser unless (i) a specified number of units of the security are sold at a specified price within a specified time, and (ii) the total

> amount due to the seller is received by him by a specified date.

17 C.F.R. § 240.10b-9.

The 1987 Bancorp offering was a "mini-max" offering. A mini-max offering is an underwriting arrangement designed to reduce risk to investors. It requires the sale of a minimum number of shares or units by the offering company on an all or none basis. Once the minimum is reached, the balance of shares or units are sold on a best-efforts basis.

The prospectus stated that Bancorp would refund investor funds if Bancorp did not sell the minimum 750 units, and raise the minimum $1.5 million, by August 12, 1987. SEC Exh. 1 at 166.[4] As of that date, the 750 minimum units had not been sold, so the underwriter extended the offering period to October 10, 1987. The SEC contends Sands and Bancorp committed fraud when they did not sell the minimum number of units by the deadline and did not return the investors' funds.

The Bancorp 1987 offering was conducted on a "best efforts, all or none basis" for the first 750 units, and a "best efforts basis" thereafter, up to the maximum 1,275 units. The prospectus stated:

> If 750 Units are not sold within 90 days (which may be extended an additional 60 days in the Underwriter's discretion) from the date hereof, all monies received will be refunded without

4. The exhibits cited in support of the SEC's motion for summary judgment are attached to the Statement of Uncontroverted Facts and Conclusions of Law.

> commissions or deductions for expenses, and without interest.

Prospectus at 2; SEC Exh. 1 at 185. Proceeds from the offering were to be held in escrow until the requisite units were sold. If the requisite units were not sold within the offering period, the offering would be terminated and the investors' money would be refunded. If the minimum number of units were sold, the funds were to be transferred to Bancorp, and the remaining units, up to 1,275, would be sold on a best efforts basis. Id.

The SEC argues Sands and Bancorp violated securities laws because (1) Sands knew the Bancorp 1987 offering was on an all or none basis; (2) Sands knew as of October 10, 1987, Bancorp had neither sold the minimum number or shares nor collected the minimum amount of funds; and (3) Sands knew the investors' funds were not refunded.

It is a violation of the anti-fraud provisions of the securities laws to attempt to make an offering appear successful when the required number of shares have not been sold. The defendant's purpose in doing so is to defeat the refund of monies paid by investors. C.E. Carlson, Inc. v. S.E.C., 859 F.2d 1429, 1434 (10th Cir.1988) Reh'g denied, 859 F.2d at 1438. Proof of scienter sufficient to establish violations of section 17(a) of the 1933 Act and section 10(b) of the 1934 Act may be shown through conduct that carries a danger of misleading purchasers such that the defendants knew or must have known of its propensity to mislead. In a mini-max offering, scienter is shown by the defendant's knowledge of the "all or none" provision, and that the funds were retained even though the minimum amount was not raised through public sales. Id. at 1435-36.

Appendix B

The Court makes no finding as to whether the PacVen offering proceeds were directed to Bancorp. As stated above, this issue presents a triable issue of fact. As to the $1 million purchase by Sands, however, it is undisputed that the funds were invested by Sands while he was a corporate insider. Sands was an officer and director of Bancorp when he invested the funds necessary to reach the minimum amount in the 1987 Bancorp offering. Although a check for $1 million was written by a Mr. Kutik, drawn on the Bank of Montreal, this check was returned unpaid. SEC Exh. 57. Sands and Bancorp have produced no evidence that the requisite funds were raised prior to the October 10, 1987 deadline. Sands purchased $1 million of Bancorp units on December 30, 1987, the date the offering closed. Bancorp failed to sell the minimum number of units by the date specified in the prospectus. Bancorp thus should have refunded the $688,000 of invested funds.

Sands argues a triable issue of fact can be found in the confusion over the date by which the funds had to be raised. The precise date, however, is of little significance. Even if on October 10, 1987 Sands had no knowledge that the requisite funds had not been raised, he did know that the minimum number of units had not been sold in November 1987 when the $1 million check was returned. See SEC Exh. 57. The investors' funds were not returned at that time or any time thereafter. Accordingly, Sands and Bancorp violated section 17(a) of the 1933 Act, section 10(b) of the 1934 Act, and Rules 10b-5 and 10b-9 promulgated thereunder.

B. Claim 3: Failure to Comply with Regulation C

The third claim in the amended complaint charges PacVen with failure to file supplemental reports on Form S-R.

Complaint, ¶ 53. Said supplemental forms are required by Rule 463 of Regulation C under the 1933 Act. The forms require (1) a description of the use of offering proceeds by category and (2) any material variance between actual use of the offering proceeds and the intended use stated in the prospectus. 17 C.F.R. § 230.463.

PacVen completed a stock offering on July 27, 1987. It filed a registration statement, signed by Sands, on January 27, 1987. SEC Exh. 26. The registration statement became effective on April 17, 1987. It stated that all funds not being utilized by PacVen for its proposed business would be held in "interest bearing accounts or investments in commercial financial institutions until such time as it appears that they will be required." Id.

Rule 463 of Regulation C requires PacVen to file a Form S-R within 10 days after the first three month period following the effective date of the registration statement. Here, PacVen was required to file a Form S-R on or before July 27, 1987. The SEC informed PacVen of its duty to file the Form S-R. Def.Exh. 65. Rule 463 further requires PacVen to file an additional Form S-R every six months thereafter, and a final Form S-R upon the later of "application" of the offering proceeds or "termination" of the offering.

PacVen filed an initial Form S-R on July 27, 1987. It stated that the funds raised in the PacVen offering, approximately $541,000, were temporarily invested in "short term bank and other deposits." SEC Exh. 27 at 242. PacVen filed no subsequent S-R Forms, and concedes it did not file said forms. PacVen has disclosed to the SEC neither the final disposition of the 1987 offering proceeds nor the interim disposition of the proceeds.

PacVen argues that it has been inactive since November 1988, and thus has not disposed of the proceeds in a way that requires filing of subsequent Forms S-R. PacVen refers to a Form 15 filed with the SEC on August 12, 1987. It further contends that at all times it acted in good faith by entrusting the filing of forms to its attorneys.

PacVen, however, has not shown that it was exempt from filing Forms S-R at six month intervals starting on July 27, 1987. The Form 15 PacVen filed with the SEC contains certification and notice of termination of registration under the 1934 Act. It provides information relevant to the trading of PacVen securities. The Form S-R, which PacVen did not file, arises under the 1933 Act and requires disclosure of the use of capital raised in public offerings and information about the raising of the capital.

PacVen has produced no evidence that it was entitled to cease filing interim Forms S-R. PacVen had the obligation to inform its shareholders of the status of their investment. Rule 463(a), 17 C.F.R. § 230.463. Further, even though the parties dispute how the funds raised by PacVen were applied, it is undisputed that PacVen did not file a final report when the funds were invested. Accordingly, the SEC is entitled to judgment on the third claim.

C. Claim 5: Failure to File Amended Schedule 13D and Form 4

The fifth claim in the amended complaint charges Sands with failure to amend his beneficial ownership statement on Schedule 13D or Form 4. Complaint, paras. 62-64. Sands was a beneficial owner of more than five percent of Bancorp. Section

13(d) of the 1934 Act, 15 U.S.C. § 78m(d), and Rule 13d- 2, 17 C.F.R. § 240.13d-2, required Sands to inform the SEC within ten days of (1) his plan to purchase additional Bancorp securities in the Bancorp mini- max offering; and (2) the increase in his ownership of Bancorp securities resulting from said purchase. See 15 U.S.C. § 78m(d)(2).

Section 16(a) of the 1934 Act, 15 U.S.C. § 78p(a), required Sands, who owned more than ten percent of Bancorp, to file a statement with the SEC disclosing his ownership at the close of each calendar month and such changes in ownership that occurred during that month. As an officer and director of Bancorp, Sands was also required to report to the SEC within ten days whenever he purchased additional Bancorp shares. 15 U.S.C. § 78p(a). Such beneficial ownership statements were to be filed with the SEC on a Form 4.

Sands owned 54.6% of Bancorp's stock prior to the 1987 Bancorp offering. Bancorp 1987 Offering Prospectus, SEC Exh. 1 at 211. Sands purchased 500 units in the offering. He spent $1 million. This constituted more than one percent of Bancorp. SEC Exh. 12 at 91. The increase in ownership by an amount greater than one percent constituted a "material" acquisition and required Sands to file with the SEC an amendment to the Schedule 13D. 17 C.F.R. § 240.13d-2(a). The Defendants argue that a Schedule 13D amendment is not required unless the purchaser increases his net position, relative to all outstanding shares, by more than one percent. This argument is unpersuasive. Section 13(d) imposes a duty on a person who owns more than five percent of a company issuing stock. When such an owner acquires, by absolute number, an additional one percent or more of the issuer's stock, he must disclose to the SEC the acquisition. It is the amount of stock purchased, not

the affect on the purchaser's ownership percentage, that triggers the reporting requirement. See 15 U.S.C. § 78m(d)(1)(D).

Sands did not amend the Schedule 13D and disclose his purchase of the 500 units in the Bancorp offering. He did not report a material change in his ownership of Bancorp stock. Sands thus violated 15 U.S.C. § 78m(d)(2). Nor did Sands file a timely Form 4 disclosing the change in beneficial ownership. Sands was an officer and director of Bancorp at the time he purchased the 500 units in the Bancorp offering. He was required under section 16(a) of the 1934 Act to file a Form 4 by January 9, 1988, 10 days after purchasing additional Bancorp shares. He filed a Form 4 on September 11, 1989. SEC Exh. 7.

The Court hereby finds that Sands violated sections 13(d)(2) and 16(a) of the 1934 Act by not filing an Amendment to his Schedule 13D, and by not timely filing a Form 4, respectively. The SEC is entitled to judgment on the fifth claim in the amended complaint.

D. Claim 6: the RIWNs and Liberian CDs

As discussed above, whether Bancorp and Sands filed with the SEC materially false and misleading reports regarding the RIWNs and Liberian CDs is a triable issue of fact. Having carefully reviewed the SEC's moving papers, and the documents filed in support thereof, the Court finds the SEC has not met its burden on the sixth claim. Accordingly, the motion for partial summary judgment on the sixth claim is DENIED.

III. Motions to Strike Affirmative Defenses

On December 2, 1994, Defendants PacVen, Bancorp, and Sands filed separate answers to the amended complaint. The

answers set forth the identical eighteen affirmative defenses. On December 12, 1994, Defendant Charles W. Knapp filed an answer in which he set forth 12 affirmative defenses. On December 16, 1994, the SEC moved to strike eleven of the affirmative defenses brought by Defendants Bancorp, PacVen, and Sands, and all of the affirmative defenses brought by Defendant Knapp. The motions were denied without prejudice to be renewed following discovery responses that were then outstanding. On May 22, 1995, the SEC again moved to strike the affirmative defenses asserted by Bancorp, PacVen, and Sands. In a separate motion filed on the same date, the SEC moved to strike Defendant Knapp's affirmative defenses.

A. The Standard

Rule 12(f) of the Federal Rules of Civil Procedure provides that the court, upon motion or sua sponte, "may order stricken from any pleading any insufficient defense or any redundant, immaterial, impertinent or scandalous matter." To strike an affirmative defense, the moving party must convince the court "that there are no questions of fact, that any questions of law are clear and not in dispute, and that under no set of circumstances could the defense succeed." Schwarzer, Tashima & Wagstaffe, Federal Civil Procedure Before Trial § 9:381 (1995) (quoting Systems Corp. v. American Telephone & Telegraph, 60 F.R.D. 692, 694 (S.D.N.Y.1973)). The grounds for the motion must appear on the face of the pleading under attack or from matter which the court may judicially notice. Id. at § 9:403.

As a general proposition, motions to strike are "regarded with disfavor because [they] are often used as delaying tactics, and because of the limited importance of pleadings in federal

practice." Id. at § 9:375; accord 5A Wright & Miller, Federal Practice & Procedure § 1381 (2d ed. 1990). Accordingly, courts often require a showing of prejudice by the moving party. Schwarzer at §§ 9:376, 9:407; Wright & Miller at § 1381. The Ninth Circuit has stated that prejudice can arise from allegations that cause delay or confusion of the issues. Fantasy, Inc. v. Fogerty, 984 F.2d 1524, 1528 (9th Cir.) rev'd on other grounds, 510 U.S. 517, 114 S.Ct. 1023, 127 L.Ed.2d 455 (1994) (district court could properly strike lengthy, stale and previously litigated factual allegations in order to streamline action). Even when the defense under attack presents a purely legal question, courts are reluctant to determine disputed or substantial questions of law on a motion to strike. Wright & Miller at § 1381.

B. Affirmative Defenses Asserted by Bancorp, Sands and PacVen

The SEC moves to strike the following affirmative defenses: the third (unclean hands), the fourth (estoppel and waiver), the sixth and ninth (failure to plead fraud with particularity), the seventh (ratification and estoppel), the thirteenth (accord and satisfaction), the fourteenth (arbitration and award), and the sixteenth (laches).

1. Affirmative Defense Three: Unclean Hands

As the third affirmative defense, Defendants allege the SEC's action is barred by the doctrine of unclean hands. Some courts have stated that the doctrine of unclean hands may not be invoked against a governmental agency acting in the public interest. Others have declined to strike the defense on the theory that the Government's conduct, if it is so outrageous as to cause

constitutional injury, may preclude equitable relief. See, e.g., SEC v. Keating, Fed.Sec.L.Rep. (CCH) ¶ 96,906, 1992 WL 207918 (C.D.Cal.1992) (Wilson, J.). In any event, the defendant must show such egregiousness that "the resulting prejudice to defendant rises to a constitutional level." SEC v. Musella, 38 Fed.R.Serv.2d 426, 428, 1983 WL 1297 (S.D.N.Y.1983).

Discovery is complete. Despite numerous opportunities to do so, the Defendants have produced no evidence that the SEC acted unconstitutionally in prosecuting this action. The unsupported allegations in the Defendants' response to interrogatories are frivolous. The unclean hands affirmative defense is stricken.

2. Affirmative Defense Four: Waiver and Estoppel

In the fourth affirmative defense, the Defendants allege the SEC "tacitly approved all alleged conduct," and therefore waived its claims and is estopped from asserting them. In the Ninth Circuit, estoppel is available against the SEC where the government's wrongful act would cause serious injustice, and where the public interest would not be unduly harmed by imposition of the doctrine. Mukherjee v. Immigration and Naturalization Service, 793 F.2d 1006, 1009 (9th Cir.1986).

On the face of the complaint, the Defendants assert a viable estoppel and waiver defense. The Court should not weigh the evidence for purposes of a motion to strike an affirmative defense. The Defendants allege that the SEC approved of certain registration statements filed by Bancorp, failed to warn Defendants about certain fraudulent transactions, and accepted the Defendants' Wells submissions. Given the high standard, the SEC has not met its burden of showing that the fourth affirmative defense should be stricken.

Appendix B

3. Affirmative Defenses 6 and 9: Failure to Plead Fraud with Particularity

In the sixth and ninth affirmative defenses, the Defendants allege the amended complaint fails to plead scienter and fraud with the particularity required by Fed.R.Civ.P. 9(b). The assertion that the complaint fails to plead scienter and fraud with particularity is an attack on the pleading. It normally provides the grounds for a motion to dismiss. The allegation that the complaint does not state fraud with particularity is not an affirmative defense on which the Defendants will produce evidence at trial. Accordingly, the sixth and ninth affirmative defenses are stricken.

4. Affirmative Defense 7: Ratification and Estoppel

The seventh affirmative defense is based on the Defendants' submission of a "Wells" report to the SEC. A Wells submission is a document filed with the SEC in which a defendant presents the evidence and legal theories he believes the SEC should consider in deciding whether to file an enforcement action. Defendants allege their Wells submission attempted to "answer[ ] unequivocally all questions raised" in the instant action. The SEC did not promptly respond to the Wells submission. In fact, Defendants did not hear from the SEC until it filed the complaint. The Defendants argue the delay prejudiced the Defendants and should bar and estop the SEC from pursuing this action.

The SEC was under no obligation to accept the assertions and arguments presented by Defendants in the Wells submissions. It did not accept those arguments, and filed the complaint. Defendants cannot estop the SEC from pursuing the

instant enforcement action because it considered and rejected the Wells submissions. The seventh affirmative defense is stricken.

5. Affirmative Defense Thirteen: Accord and Satisfaction

The thirteenth affirmative defense Defendants raise is "accord and satisfaction." An accord and satisfaction is the "substitution of a new agreement for and in satisfaction of a pre-existing agreement between the same parties." Red Alarm, Inc. v. Waycrosse, Inc., 47 F.3d 999, 1002 (9th Cir.1995). The SEC argues that the Court should strike this affirmative defense because there is no evidence that the SEC offered, and Defendants agreed, to settle the action.

Defendants claim that on or about February 19, 1993, Defendant Sands entered into an accord and satisfaction with the Federal Reserve Board ("FRB"). The SEC is thus barred from bringing the instant action because it is based on the same transaction that was the subject of the accord and satisfaction with the FRB. Defendants implicitly argue that the SEC may not pursue an action which the FRB settled because the SEC and FRB are interrelated agencies. Because the impact of the alleged accord and satisfaction between the FRB and the Defendants is disputed, the Court will not strike the thirteenth affirmative defense.

6. Affirmative Defense Fourteen: Arbitration and Award

The fourteenth affirmative defense Defendants raise is for "arbitration and award." The SEC contends that it has never participated in arbitration proceedings with Defendant Sands, and that "by no stretch of the imagination" has either party

received an award. Neither of the parties has produced evidence relating to an arbitration. The Court finds that the SEC has not met its burden in demonstrating that the Court should strike this affirmative defense.

7. Affirmative Defense Sixteen: Laches

The sixteenth affirmative defense Defendants raise is laches and undue delay on the part of the SEC. It is well established that laches is not an affirmative defense against the United States. Costello v. United States, 365 U.S. 265, 81 S.Ct. 534, 5 L.Ed.2d 551 (1961). The laches defense is therefore stricken.

C. Affirmative Defenses Asserted by Defendant Knapp

The SEC filed a separate motion to strike certain affirmative defenses asserted by Defendant Knapp. Defendant Knapp has filed no opposition. In addition, the affirmative defenses at issue have already been stricken in previous orders by the Court. Accordingly, the Court hereby orders stricken from Defendant Knapp's answer the third, fourth, fifth, sixth, eighth, ninth, and eleventh affirmative defenses.

CONCLUSION

For the foregoing reasons, Defendant Sands' motion for summary judgment is DENIED. The SEC's motion for summary judgment is GRANTED in part and DENIED in part. Judgment is granted for the SEC on the first, third and fifth claims in the amended complaint. There is a triable issue of fact as to the sixth claim. The appropriate remedy is also an issue to be determined at trial.

Appendix B

The following affirmative defenses are ordered stricken from the answers filed by Defendants Bancorp, PacVen, and Sands: the third (unclean hands), the sixth and ninth (failure to plead fraud with particularity), the seventh (ratification and estoppel), and the sixteenth (laches). The third, fourth, fifth, sixth, eighth, ninth, and eleventh affirmative defenses are ordered stricken from the answer filed by Defendant Knapp.

IT IS SO ORDERED.

APPENDIX C — JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA, WESTERN DIVISION FILED AUGUST 28, 1996

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
WESTERN DIVISION

CASE NO. CV 93-7510 JGD

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

LEONARD S. SANDS, et al.,

Defendants.

The evidence and issues presented having been fully considered, and a decision having been duly rendered, the Court hereby ORDERS that judgment in the amount of $688,000, plus prejudgment interest calculated from December 30, 1987, to the date of this judgment, be entered in favor of Plaintiff Securities and Exchange Commission, and against Defendants Leonard S. Sands, First Pacific Bancorp, Inc., and PacVen, Inc. The Court further ORDERS that Leonard S. Sands, First Pacific Bancorp, Inc., and PacVen, Inc., their servants and employees, and other persons in active concert or participation with them, are permanently restrained and enjoined from violating or aiding and abetting violations of section 17(a) of the Securities Act of 1933 [15 U.S.C. § 77q(a)], and sections 10(b), 13(a), 13(b)(2)(A) and 15(d) of the Securities Exchange Act of 1934

(15 U.S.C. §§ 78j(b), 78m(a), 78m(b)(2)(A), and 78o(d)]. The Court further ORDERS that, pursuant to Section 21(d)(2) of the Securities Exchange Act of 1934, 15 U.S.C. § 78u(d)(2), Leonard S. Sands is permanently and unconditionally prohibited from acting as an officer or director of any issuer required to file reports pursuant to Sections 12(b), 12(g) or 15(d) of the Securities Exchange Act of 1934 [15 U.S.C. § 781(b), (g) or 78o(d)].

IT IS SO ORDERED.

Dated: August 28, 1996

s/ John G. Davies
JOHN G. DAVIES
United States District Judge

APPENDIX D — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT DENYING PETITION FOR REHEARING AND REJECTING SUGGESTION FOR REHEARING EN BANC FILED JULY 20, 1998

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 96-56687

D.C. No. CV-93-07510-JGD

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

FIRST PACIFIC BANCORP; PACVEN, INC.,

Defendants-Appellants,

and

LEONARD S. SANDS; CHARLES W. KNAPP; BERRIEN MOORE; DANIEL S. GEIGER; MULK RAJ DASS; APEX INVESTMENT SECURITIES, LTD.,

Defendants.

Appendix D

No. 96-56690

D.C. No. CV-93-07510-JGD

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

LEONARD S. SANDS,

Defendant-Appellant,

and

Defendant

FIRST PACIFIC BANCORP; PACVEN, INC.; CHARLES W. KNAPP; BERRIEN MOORE; DANIEL S. GEIGER; MULK RAJ DASS; APEX INVESTMENT SECURITIES, LTD.,

Defendants.

Before: FARRIS, O'SCANNLAIN and FERNANDEZ, Circuit Judges.

The panel has unanimously voted to deny the appellants' petition for rehearing. The suggestion for rehearing en banc was circulated to the judges of the court, and no judge requested a vote for en banc consideration.

The petition for rehearing is DENIED and the suggestion for rehearing en banc is REJECTED.

APPENDIX E — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT FILED AUGUST 17, 1998

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 96-56687
CT/AG#: CV-93-07510-JGD

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

FIRST PACIFIC BANCORP; PACVEN, INC.,

Defendants-Appellants,

and

LEONARD S. SANDS; CHARLES W. KNAPP; BERRIEN MOORE; DANIEL S. GEIGER; MULK RAJ DASS; APEX INVESTMENT SECURITIES, LTD.,

Defendants.

Appendix E

No. 96-56690
CT/AG#: CV-93-07510-JGD

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

LEONARD S. SANDS,

Defendant-Appellant,

and

FIRST PACIFIC BANCORP; PACVEN, INC.; CHARLES W. KNAPP; BERRIEN MOORE; DANIEL S. GEIGER; MULK RAJ DASS; APEX INVESTMENT SECURITIES, LTD.,

Defendants.

APPEAL FROM the United States District Court for the Central District of California, Los Angeles.

THIS CAUSE came on to be heard on the Transcript of the Record from the United States District Court for the Central District of California, Los Angeles and was duly submitted.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause be, and hereby is AFFIRMED.

Filed and entered April 28, 1998